



# Emerging Trends in Real Estate®

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## Europe

  
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**Urban Land  
Institute**

# Emerging Trends in Real Estate® Europe 2012

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# Emerging Trends in Real Estate® Europe

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# Executive Summary

As *Emerging Trends 2012* went to press, Europe's economic outlook remained a grave concern: for its politicians, its financial markets, and not least of all, for its real estate industry. Confidence in Europe's economic outlook had tumbled to a two-year low, German factory orders had dropped by more than they have in almost three years, and the euro—which still threatened to evaporate—was poised for its fifth weekly loss against the dollar, the continuation of its longest downward run since February 2010.

It is little wonder that this year's report is bearish in outlook. As interviews were being conducted around the region in the closing weeks of 2011, U.K. property values fell for the first time in almost two and a half years, and Eurohypo and Société Générale announced their withdrawals from the property lending market. On a macro-economic level, Italy's borrowing costs were creeping up to unsustainable levels, and breakup of the Eurozone could not be ruled out. To many, the current real estate climate is worryingly familiar, wrapped up in a renewed liquidity crisis that feels almost as severe as the one that followed Lehman's collapse.

Inertia is a common coping mechanism, as investors wait to see when and how Merkel and Sarkozy solve Europe's financial riddles. But given that many forecasters believe the region will dip into recession this year, together with a decreasing supply of bank finance and little job creation, interviewees and survey respondents were also worried about the long term. One of interviewees' key concerns is how to grow returns, as well as headcounts, if 2012 is a year of no growth.

These questions were based on a discernible change in the occupier mood during the second half of 2011, as interviewees reported that the latest debt troubles, government spending cuts, and increased unemployment were causing businesses to put moves and expansion on the back burner. Rental and leasing conditions in the retail and industrial sectors will also suffer as insecure consumers keep money in their pockets.

Respondents believe that the availability of property finance in 2012 will remain tight for most, continuing a fresh downward trend felt since last summer. Banks are subject to significant regulatory pressure to reduce their assets to meet capital requirements, and the widespread view in this report is that commercial real estate lending will be hit disproportionately by banks' need to rebalance portfolios. When debt is found, it will be expensive, as financing costs for banks continue to rise, even without the capital cost of meeting regulatory requirements. Importantly, some of bankers interviewed also held this view.

Although new lenders are expected to increase their presence this year, the change is not expected to be significant—at least not for the time being. Mezzanine lenders need senior lenders to get debt into the marketplace, and insurance companies need the time to build the right infrastructure to deploy capital. They are also focused on lending to the very best companies and properties, as are the bank lenders still in the market. Although only a faint trend this year, the changing face of prop-

erty finance will be a theme that continues to feature over subsequent *Emerging Trends* reports.

Set against this backdrop and against the ongoing uncertainty of how regulations such as Basel III, Solvency II, and the Alternative Investment Fund Managers Directive will eventually treat the market, interviewees were having difficulty in devising strategies and remaining confident about any given property sector or country. Making investment decisions has become a granular process, and few places are considered a sure bet.

For this reason, surveys on favoured markets and sectors reflected a number of interesting trends. Cities that ranked highest seemed to do so because their economic outlooks were considered good or stable. Thus, Istanbul is the top market for two years running, but that ranking is more a reflection of its long-term economic future than a sign that investors are about to rush to place their capital in the market. Equally, the languishing of cities in Italy, Spain, Portugal and Greece at the bottom of rankings, in light of concerns over their financial health, does not mean capital will totally avoid these markets; in the interviews, opportunistic investments in Spain and Italy could not be entirely ruled out given the expectation that desperate banks there will begin to release assets this year.

The real estate markets in capital cities such as Paris and London are, as always, considered most able to withstand economic difficulty, but their place in the city rankings—respectively sixth and tenth of 27 cities and behind places such as Warsaw—reflects a growing concern that the U.K. and French capital cities could have reached a pricing peak. Interestingly, while outsiders rate Warsaw highly, Warsaw-based interviewees still displayed the same concerns about the market as anyone else.

Is any relief likely in 2012? The key is the banks, notably 1) how the regulatory pressures they are facing will ultimately affect their appetite to lend to commercial real estate, and 2) whether the onset of a second banking crisis caused by sovereign debt issues finally stimulates the release of assets and creates buying opportunities for hungry investors.

Many *Emerging Trends* interviewees believe that 2012 could be the year that investors have been waiting for, and asset and loan sales will come. They have hoped for it every year since the downturn began, but finally they may find what they have been looking for; pressures from all directions on the banks could make finding solutions imperative. Their need to deleverage, coupled with an environment in which new debt will be significantly less than before, is likely to create increased opportunities for those with the equity to deploy and, importantly, the requisite skills. Whether investors will get the bargains they are aiming for is still a contentious issue as investors and banks claim they intend to stick to their guns over pricing. Whatever the outcome, distress sales will be a more prominent feature of the market this year than last. As one interviewee put it, "The banks were waiting for a better day, and there isn't going to be a better day."

## Preface

A joint undertaking of PwC and the Urban Land Institute, *Emerging Trends in Real Estate® Europe* is a trends and forecast publication now in its ninth edition. The report provides an outlook on European real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues.

*Emerging Trends in Real Estate® Europe 2012* represents a consensus outlook for the future and reflects the views of more than 600 individuals who completed surveys and/or were interviewed as part of the research process for this report. The views expressed herein, including all comments appearing in quotes, were derived from these surveys and interviews and do not express the opinions of either PwC or ULI. Interviewees and survey participants represent a wide range of industry experts—investors, developers, property companies, lenders, brokers, and consultants. PwC and ULI researchers personally interviewed 310 individuals, and survey responses were received from 386 individuals whose company affiliations are broken down as follows:

Fund/investment manager	28.5%
Real estate service firm	22.5%
Private property company or developer	18.4%
Bank, lender, or securitized lender	8.5%
Publicly listed property company or REIT	7.5%
Institutional/equity investor	6.0%
Other entity	7.3%

A list of the interview participants in this year's study appears at the end of this report. To all who helped, the Urban Land Institute and PwC extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.



# Prepare for the Big Freeze

“We are operating in an environment that is simply impossible to model.”

The news arrived like a punch in the dark. It had been one of the biggest, most consistent lenders to the real estate industry in recent years, but on 1 November 2011, Commerzbank informed the market that its property finance unit, Eurohypo, would suspend all new business lending—with immediate effect.

Commerzbank’s decision may be temporary, but in any case, it is a moot point. Eurohypo was one of the last banks to close during the credit crunch and one of the first to reopen in its wake. Its presence therefore—especially in the U.K. and German markets—had become symbolic of a market slowly repairing itself.

The German lender not only appeared to be functioning, but it was also willing to undertake meatier loans. It had been bold, too, innovating with fellow debt providers and new structures to get fresh debt into the starved marketplace. All this was enabled by that reliable crutch, the Pfandbrief market.

Others duly followed. The announcement by Société Générale (Soc Gen) in the summer that it had fired up the engines on a new U.K. lending drive was more evidence of a market moving gently in the right direction. But two weeks after Eurohypo’s announcement came a dramatic turnaround in strategy: Soc Gen was also out.

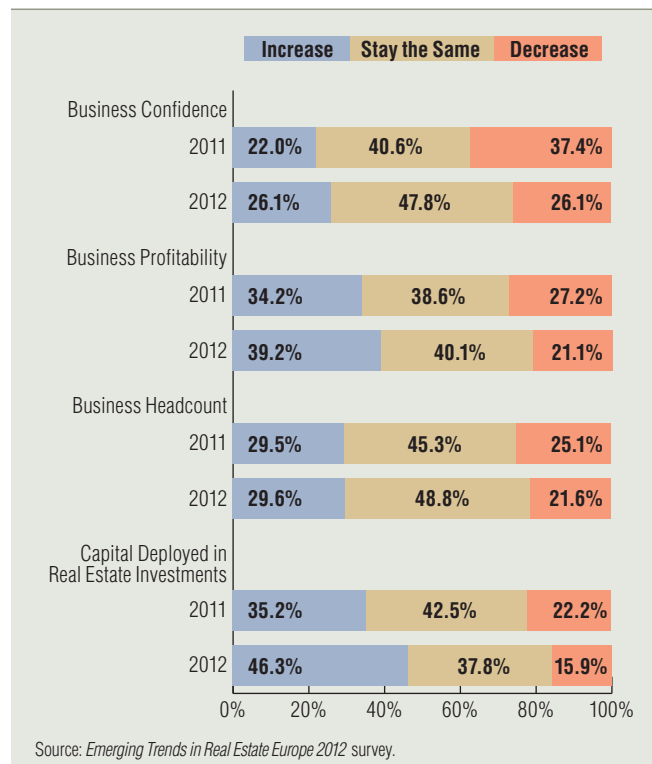
So, once symbols of a recovery, Eurohypo and Soc Gen now represent the market’s fragility, demonstrating how quickly sentiment can reverse in the current climate and how what the industry faces is so much more complicated than first thought.

In the great scheme of the downturn, as banks slide back down the hill, 2012 will be the toughest year yet for Europe’s real estate market. These two cases throw into sharp relief the struc-

tural shifts underway in the European property industry and signal that 2012 will be the year that their real effects will begin to be felt. These are not just changes that have threatened the

EXHIBIT 1-1

## Real Estate Business in 2011 and 2012





industry ever since Lehman's collapse, however; they include new ones thrown into the mix by the onset of the sovereign debt crisis this summer.

Therefore, 2012 marks the beginning of the "new normal," an era that will be characterised by more negatives than positives in its early years. It will be the year that property financing becomes a major casualty of the measures banks take to deal with regulatory and macro-economic-level pressures, as interviewees continue to see "banks leaving the market day by day."

It will be the year the market finds that, as banks set about deleveraging, the process will not loosen up capital for fresh property lending, as it gets diverted to lower-risk or more politically palatable industries.

It will be the year when the market sees debt become increasingly short term and expensive, as lenders pass on the costs of regulation to borrowers.

And because of scarcity of traditional debt providers, 2012 will be the year when the need to find alternative sources of funding becomes imperative.

Pulling all these strings, of course, is an economic crisis that is wreaking havoc with no map or direction. As one interviewee put it: "We thought that the outlook was uncertain in 2009. But we didn't understand what the definition of uncertainty was back then. Now we do. Even the economists admit they don't know what is going on. We are in a truly unique time." "No one talks about the risk-free returns on government bonds anymore. The whole system is up for grabs," said another interviewee. Other interviewees opined: "The economic situation is enormously complex at the moment—we are operating in an environment that is simply impossible

EXHIBIT 1-2

### Survey Responses by Country

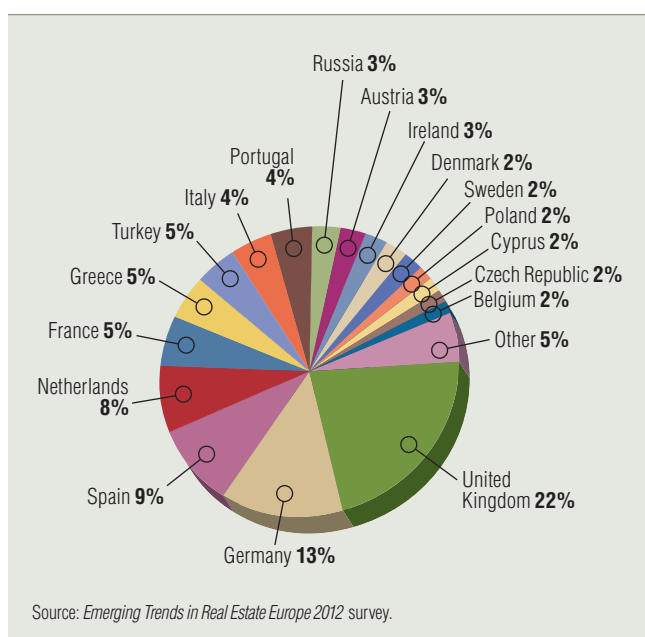
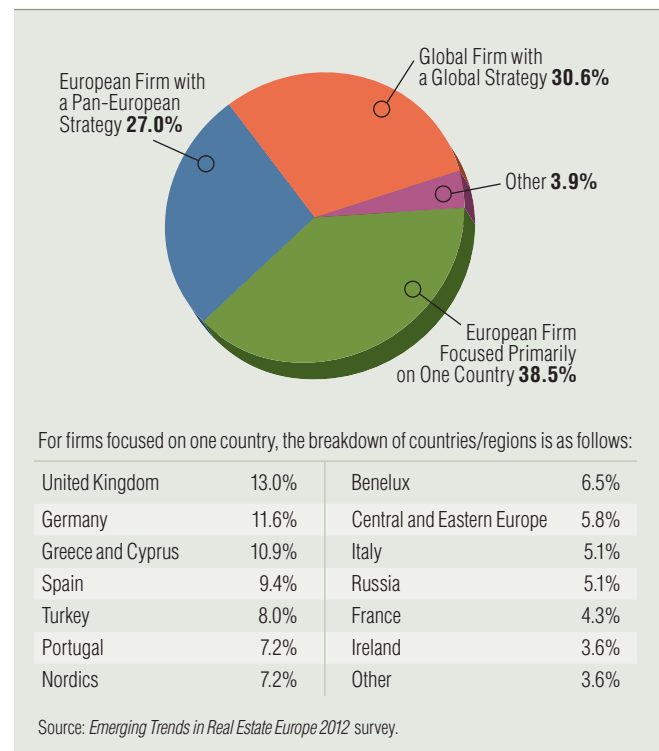


EXHIBIT 1-3

### Survey Responses by Geographic Scope of Firm



to model"; "Things are changing by the day and could go catastrophically wrong at any time"; and "The situation is total paranoia for financial institutions and operators."

At the time of writing, rates on Italian and Spanish bonds were scaling upwards while France was on the brink of losing its AAA status—just one saga in a crisis that was leading to predictions of recession across the Eurozone in 2012. Economists were also becoming increasingly convinced some breakup in the Eurozone was likely—either through the exit of one member such as Greece or by complete disintegration—as policymakers saw the year out having taken no decisive action to rescue the currency union.

As the future of the euro hung in the balance, interviewees said that divorce would be so catastrophic that its possibility could not be entertained, hoping that the European Central Bank would fire a "silver bullet" and guarantee Italy's and Spain's bond markets. "Breakup? That is such a bad scenario, it would be so bleak that the least of all our problems would be that we have put money into real estate." "If the politicians don't find a solution—I don't know what happens. That's why they can't afford not to." "If you really believe the euro will break up, you should stop investing because the outcomes are so unpredictable: Germany might move out, the euro would plummet, but the outcome for all economies would be bad. We are still hopeful that the powers-that-be deal with the situation, but I think it will take a near-death experience to bring it about."

Whether the eventual answer to Europe's debt issues is inflation or austerity, the same questions for the property industry will remain as the region adjusts to new fiscal realities: "How long will this take?" "Is 2012 year three of a five-year recovery, or year three of a ten-year recovery?" "Will all of this economic uncertainty translate into fewer jobs, fewer occupiers making decisions, and less consumer spending? Yes, all of that is coming."

## Depressed Appetites: The Economy

Sitting in the middle of depressed banks and an even more depressed economy—two major forces vital to the health of European real estate—is a property market in a state of inertia at the beginning of 2012.

"We have realized that political leaders are not smarter or more aware of our problems than we are. We are in a situation that has become completely unmanageable—the amounts are staggering. People are becoming aware that they will have to pay for these problems—and we are talking about numbers previously unheard of. It will take years to solve the problems in Europe."

Whether an interviewee was a financier, fund manager, occupier, investor, or developer, "sitting on hands" and doing nothing was considered the smartest thing to do. Said one interviewee: "2012 will be a 'lost year' in terms of our investment activity. There is equity in the market, but it will not enter at current prices, yields, and expected return." "The current market offers such a different way to do business that no business is being done."

By year-end, the sovereign debt crisis had taken its toll on investors' appetites—even for core property. Interviewees reported that if decisions were being made to invest, they were made on the basis of where one would lose the least money.

Third-quarter data showed €32.2 billion of property sales in Europe, representing a 22 percent year-over-year gain and an improvement from the second quarter of 2011, reports Real Capital Analytics. But interviewees interpreted that result as evidence that transaction data simply were not yet reflecting the turnaround in sentiment. They expected that fourth-quarter 2011 and first-quarter 2012 data would. "Assets are only going to get cheaper so why rush? Who wants to catch a falling knife?"

"We are sitting at the precipice of absolute implosion, so it is difficult to say I have conviction. Do things float like this or will they fall? Do you make an investment? If so, you need investments with downside protection and ones that can protect you with current income rather than price appreciation because I don't see where that is going to come from. In all my 23 years, I have never seen anything like this."

The depression was already evident in the occupational market, however, where interviewees reported demand for new space being switched to the back burner as businesses began holding off from committing and opting to renew

EXHIBIT 1-4

### European Economy in 2012

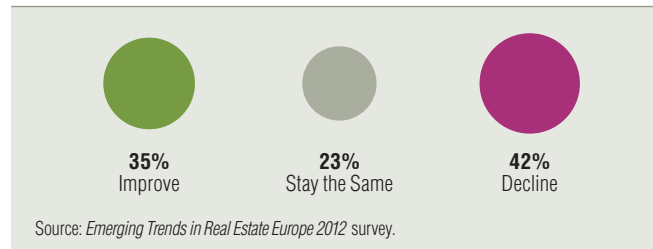
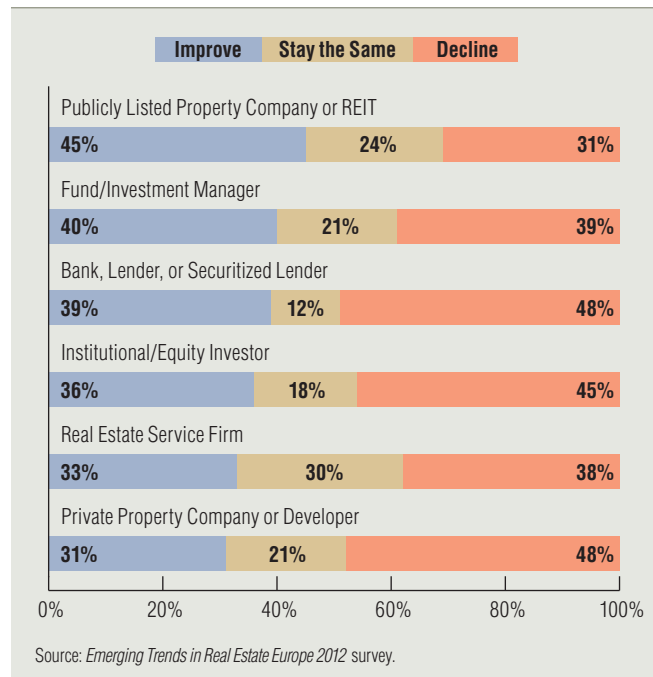


EXHIBIT 1-5

### Views on the European Economy in 2012, by Business Type



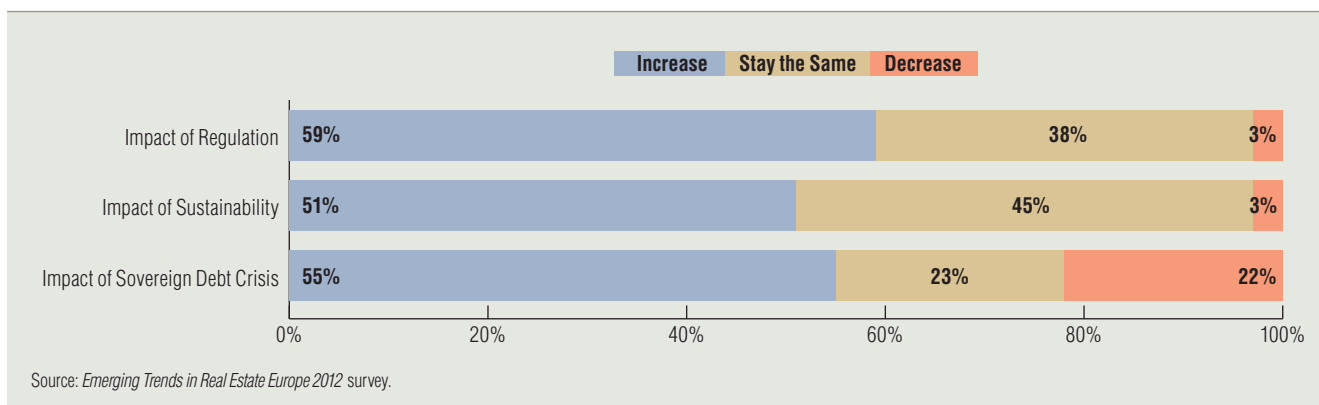
existing leases for the short term instead. "There has been an extraordinary change in sentiment: in occupier demand, at the banks—a general nervousness has set in. It starts with corporate activity; if no one is signing leases, then it all starts to slow down. And we have seen that in all major markets in Europe, in all sectors."

## Creationism

Darwinism defined last year's *Emerging Trends* report. But this year, it is about creationism. Increasing unemployment and high prices for fuel and utilities will put escalating pressure on consumers' pockets, meaning interviewees find it hard to see demand drivers for 2012.

Regionwide economic malaise and poor growth prospects are affecting interviewees' assessments, and even leading

EXHIBIT 1-6

**Real Estate Business Issues for 2012**

global cities such as London, the “gold bar of real estate,” are not perceived as entirely watertight. Even against this backdrop, however, doing nothing is not a survival strategy for the long term, and as the market prepares for what some refer to as a Japan-like “lost economic decade” in Europe, the game for 2012 is about flourishing in spite of what is out there.

Strategies must be created without much faith in the outside world—be it the economy, banks, occupiers, capital values, or capital-raising capabilities. And decisions must be guided by rigorous underwriting, focus on cash flow and capital expenditure with few assumptions about much else. “If you assume no economic growth, then the economic situation isn’t relevant to what I am doing,” said one.

This means that in 2012, asking interviewees about their favoured sectors, cities, or countries reaped little reward: very little can be depended upon or viewed as a wholesale must-buy. Unable to define concrete opportunities, interviewees said that instead they preferred to pursue eclectic investment strategies.

“Everything is so property specific that we are now staying away from making judgments about asset classes. Real estate has become a very granular business—there are so many different possible outcomes. You have to underwrite each specific situation on its own merits. For the right investors, skill sets, and capital, incredible investments are possible. But lots of questions need to be answered before you do anything.”

“How do you make money?” asked one. “The ultimate challenge is that in this zero-growth, zero-yield compression market, it’s about growing with no growth.”

“Economies do not have to rebound. They can become flat for a long time, and that is what we are facing. You just say, ‘Okay, in a flat economy, what is going to happen?’ Will ports be abandoned to cut costs? That could be exciting. Or perhaps the U.K. will build a mega-airport in the Thames Estuary and infrastructure will be a mechanism for growth. It doesn’t mean we all have to jump off the bridge.”

## Depressed Appetites: The Banks

“It is very hard to have a strategic plan for next year,” said one property lender. “I do have plans, but a lot of it is reactionary. It is not a good time to be a property banker.” It is not a good time to *need* a property banker, either. Property investors are having a tough time making themselves heard above the multitude of issues banks are facing from all directions, and that theme is set to intensify in 2012.

Property businesses of some lenders are struggling to justify themselves to management boards. “We face questions internally, such as how much has property lost the business over the last four years, is real estate making money for the bank today, and will it make money for the bank in the future? I expect many of my peers are the same,” said one.

What everyone knows is that the downward pressures are larger than the industry, and that is what makes the situation so dire. The credit quality of legacy loans is not necessarily forcing banks out of the market; the liquidity and balance sheet of Eurohypo’s parent company, Commerzbank, and wider macro-economic factors prompted the suspension.

“Banks have to raise significant amounts of money over the next six months. Assuming they manage to do all of that, governments will put banks under pressure to lend, but property is not a priority over consumers and corporations.” “There is a complete lack of understanding from borrowers about what banks are going through. Eurohypo stopped lending, and people took it personally. It was simply the parent shrinking the balance sheet.”

As those strains on balance sheets promise to increase this year, banks will become increasingly picky about the types of clients they take on and the types of business they do. “If it is long dated, capital intensive, we are shying away from it—and that includes property.”

And if, after all of that, any hunger is left to lend, regulators will continue to do their best to suppress it, by ensuring banks manage the level of property lending in their books. “My feeling from the FSA [Financial Services Authority] is that



they want people to control the level of property lending so it doesn't become disproportionate; they don't like the fact that property is so cyclical. With Irish banks, it reached 60 percent of their books and that is what has made them unstable," said one banker. "It may become so expensive to lend, banks may decide not to do it at all," said another.

Aside from these macro pressures, some consider property finance unattractive because of the limited amount of business it brings for the bank. "There are generally no other forms of business tie-in. If you lend to a FTSE 100 company, there is a lending relationship there; they might put stuff on deposit for you or use the wealth management business. Property will compete with these other types of clients that offer a wider range of opportunities."

For those that do offer finance, it will be at "considerably higher margins" than in the past. The few bankers interviewed that confessed appetite for new property loans said that they were "not desperate to put money out there," opting to pick and choose assets that provided them with ideal terms.

New entrants into the space will be similarly choosy.

Insurers are widely expected to increase activity this year but only at terms that perfectly suit them. Currently, ten life insurers are active in the United Kingdom and continental Europe, according to DTZ Research—including AIG, Allianz, AXA, Aviva, Legal & General, Met Life, M&G, and Canada Life—a number it says is likely to double over the next three years.

To match liabilities, such investors will feast on a menu of large chunks of prime-focused, long-term (upwards of five years), and fixed-rate debt that will primarily benefit those in the market that do not really need it. "It will be helpful, but they can't solve the problem. And it will take them at least five years to build teams and get the infrastructure right [to deploy significant amounts of capital]."

The good news for bankers that find themselves underemployed in this environment is that interviewees foresee them stepping in to orchestrate financing as brokers for the institutions that have equity but no expertise, or joining these firms wholesale. "Quality teams can process loans—that's what insurance companies need."

## Diversity of Debt Providers

**O**n the flip side of the retreat of banks from the industry is that interviewees are beginning to consider how they work with debt in a different way going forward.

Historically, Europe's property market has been dependent on bank funding—not just for senior debt, but also for mezzanine slices. These same banks were the major buyers of commercial mortgage-backed security debt, too.

But the realisation is growing that this structure is unhealthy for the industry to operate in, and during interviews, both borrowers and bankers were clear that the market, one way or another, needs to consider how it diversifies its funding sources in the future. "In five years' time, getting money into property will be more complex and so will the number of debt providers."

"In Europe, banks are still the largest providers of capital, but in the United States, there are a handful of different sources of debt." "In response to the reluctance of banks, we will see a number of different debt

vehicles coming into the space." "The U.K. has been too reliant on the U.K. banks, and what we are missing is an interface. People don't know how to access the money in the sector. We have to diversify the funding base."

As one banker said: "There are alternative sources of capital coming through, and the market is working as it should do. We are seeing insurers and mezzanine funds on the horizon. The capital stack is being replenished, although at a higher cost, and it is making a difference. You also have private equity funds that have raised cash that can support the deleveraging of the banks. I think we will end up with a more diverse market in the future. As more people see an opportunity in the debt market, we will see more of these funds being raised."

For those with no legacy issues and equity to invest, debt is a good business to be in. "Banks are figuring out how you shrink, not grow. But it is a great time to lend. Values in the U.K. are down by 30 percent. What could be better than lending against

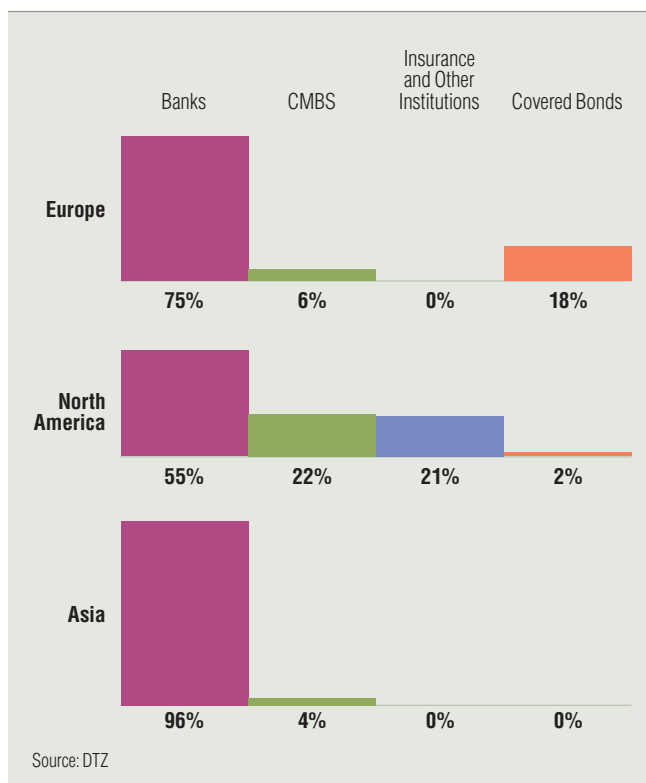
assets that are 30 percent cheaper than 2006? That is why we are trying to buy a lending bank."

However, this shift will be not just about having a diverse type of debt provider in a portfolio, but also about exploring diverse types of debt, which may include accessing the U.S. private placement market and issuing convertible bonds or debentures, although all are currently options only for weighty listed or private companies. A handful of such companies had success with accessing the U.S. private placement market in 2011, for instance.

Some interviewees were optimistic that the emergence of new lenders in Europe provides a unique opportunity to change the basic lending terms in the market: fixed-rate, longer-term loans without swaps. As DTZ reports, "The U.S. markets have used this type of debt for many years, which despite its many other problems, has no debt funding gap."

In chapter 2, these changes are assessed in more detail.

EXHIBIT 1-7

**Outstanding Debt by Lender Type**

## Get Protection

Close analysis of every move made is seen as the right step forward in enabling firms to shield themselves against unknown economic, political, and financial terrain. Economists have cut already pessimistic forecasts for Eurozone gross domestic product (GDP) growth to –1 percent this year and –2.5 percent in 2013, representing a total decline in output similar to that seen in 2008 and 2009.

In this climate, the main factors in evaluating a real estate asset—quality of tenant and yield—can no longer be trusted and could easily deteriorate. “You have to work with your portfolio, not just trust your running NOI [net operating income].”

Interviewees reported they were preparing for long-term economic headwinds and uncertainty by applying a “fixed-income-style analysis” to real estate: assessing the riskiness of the income stream for the full term of the lease. There is no sense, some said, in looking at a tenant’s credit rating today; investors now need to assess credit risk over 20 years. “It is about seeing property as a corporate bond with a roof. Real estate is not a growth asset but an income stream with a bit of growth.” “We are buying cash flow—sustainable and growable cash flow.”

One interviewee disclosed that his firm had recently invested in data on businesses in the United Kingdom “from

pastly sellers to large London corporates” to enable it to assess credit risk long term and properly price the cash flow for lease structures. “Through that system, we were alerted when one of our tenants became the subject of a takeover, which enabled us to make an approach and redraft the lease before even their staff had heard about it. We made sure we were the first party that tenant had to deal with as part of that situation. This kind of insight allows us to get on top of tenant risk and, if need be, sell an asset before the market prices that risk in.”

Such rigour was echoed across interviewees, who reported that detailed monitoring of occupiers and opportunities is more essential now than in 2008. “It has all become very granular. Purchase opportunities require more rigorous analysis; assessing tenants is done on the basis of a line-by-line review rather than taking a holistic approach,” said one interviewee. “Major corporates in the U.K. are in good shape, but the question is not about whether they will fail but how much profit they will make.”

Investors need to beware of value confusion, too. Spreads between prime and secondary yields are widely expected to increase this year, with value for some property reverting to land values.

As national austerity measures take root, especially in regional cities across Europe, large reductions in public sector employment are expected to affect demand for offices and retail long term.

“There’s a big segment of property in Europe where the value of that property is really only the land it is on. It relates to regions in decline, losing population, losing jobs. This stuff all got inflated through the bubble along with everything else. So there is a fairly large slug of property that will be going to low and no value. Over the course of 2012, therefore, there will be evidence of value that causes confusion. Assets will appear to be very cheap, but it will be empty and probably stay empty.”

“Investors should look to do a short-term trade where you are in and out in 12 to 18 months and getting the bulk of your money back in six months, or find the longest income stream you can find and sit and ride it out on the basis you’ve got the best bulletproof asset you can buy and a ten- to 20-year

EXHIBIT 1-8

**Respondents’ Global Real Estate Portfolio by World Region and Year**

	2011	2012	Anticipated in Five Years
Europe	86.9%	86.5%	82.8%
United States/Canada	7.4%	7.6%	8.3%
Asia Pacific	3.7%	3.8%	6.0%
Other	2.1%	2.1%	3.0%

Source: *Emerging Trends in Real Estate Europe 2012* survey.

income play. What lots of people are doing is sitting in the middle somewhere—they can't get long income, so they buy a six- or seven-year lease and price it at 12 percent. But that is dangerous; you are paying investment value to own an opportunistic asset."

## Buy Value, Not Core

Not everyone is so wary, of course. And those with asset management capabilities see a wealth of opportunity in offbeat places and sectors in 2012.

Whereas interviewees in last year's *Emerging Trends* report were focused on core investment plays, this year, some interviewees were more circumspect: "Core is so overpriced; people are moving back up the risk curve"; "Core markets like London and Paris are so overpriced that we need to be very careful now"; "A great deal of equity is focused on core space, a lot less on opportunity and value-added products. I understand why that is happening, but it is backwards in where the opportunities are today and core assets are overvalued."

In the *Emerging Trends* survey, respondents suggested that 47 percent of allocations in 2012 would be in core or core-plus investments and 53 percent would be in riskier value-added, opportunistic, debt acquisition or development investments (see exhibit 1-9).

Those who invested recently in core assets in safer cities such as London, Paris, and Frankfurt can expect reliable returns but little or no capital appreciation. Those who bought at the bottom of the market should now try to cash in. As one seller said, "We are making more money than we should selling core assets."

Overseas investors, who bought London assets at keen prices to get a foothold in the market, are also about to learn the U.K. capital is a volatile market and become more return focused in the future, though sovereign wealth funds and insur-

ers are not likely to be deterred from these buys anytime soon.

For investors seeking higher returns and that have the asset management capabilities and the equity, secondary and value-added properties are *de rigueur*. "So pricing of secondary is about to fall further, but that doesn't mean the real or potential value of secondary is about to fall further. Secondary will trade at prices below value; that will be its cash flow."

Investors in this field are looking at ungeared double-digit rates of return. But horizons are clearly long term. In smaller lot sizes of up to £10 million, these assets are also in demand by investors local to that market, which are prepared to pay all equity. But to put so much capital at risk without the near-term prospect of income, the only investors likely to make a success of this strategy are those with the right skills to manage intensely and wait for value or bank debt to return. And that is before the possibility of the tenant disappearing has been factored in. "Making a profit will rely on pricing and finding an angle. This plays to the strengths of those with deep asset-management skills." "Buying secondary assets is close to owning a hotel; it is an operating business. And you have to approach it that way."

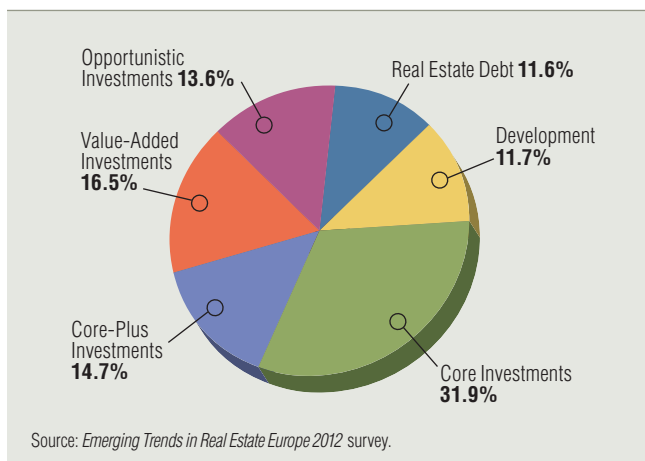
Numerous longer-term noncore investment strategies are emerging, ranging from wind farms to Turkish retail to data centers, including the following:

- Solar energy parks and wind farms. Interviewees identified these as a "growth business." Fewer fossil fuels and more energy use globally equal increasing dependence on renewable power. "Hook up to the grid and lease it to the government for 25 years." The drawbacks are securing planning consents, but "the more difficult that is, the greater the value."
- Gas storage. "There's a real shortage of it in the U.K. It is still property; it doesn't have to be a tenant in an office block. Your exit route is to institutional buyers."
- Emerging asset classes such as health care, hospitals, and data centres. These are considered interesting to the capital markets and to institutions looking for a long-term stable income stream.
- If an investor can take a ten-year view, Turkey looks good, especially retail, where a consumer-driven economic expansion is underway as GDP soared 8.8 percent during 2011. But a widening current account deficit and fears of inflation mean it is not a one-way bet. "It's an emerging market, so it isn't just about great returns; it's tenants walking away, contracts not being contracts—a roller-coaster ride. But we look at our centres today and see footfalls improving, spending is on the up, and it is where international brands want to be."

Over the short term, favoured noncore strategies range from budget hotels to mezzanine financing, as evidenced by the following investor recommendations:

- Hunt for opportunities on the edges of prime districts of major cities: assets that offer opportunities to bring a building up to prime standard in a location on the brink of turning into prime. "It is too late to invest in the City of London, but a refurbishment on the edges of the City could be interesting if you

EXHIBIT 1-9  
Investor Allocation Preferences by Strategy





can get out within two years, before the towers come. It won't be about rental growth but will come back to pricing."

- Create budget hotels, especially in London's Waterloo, Paddington, King's Cross, or Bishopsgate areas. Make sure to team up with a partner with skin in the game; buy secondary offices and convert them. "A fantastic business, recession proof and yielding 12 percent. The exit route is to one of the bigger hotel chains, or you can sell them individually."

- Offer mezzanine financing for residential developers, where senior debt providers are lending 50 percent loan to value (LTV) for the right asset. "We top up to 70 percent LTV. The market is there for that."

- Invest in London residential, as wealthy private investors from Greece and Italy seek a home in a safe haven. Starved of development finance and a tangible imbalance between supply and demand, these properties are seen as safe because if you cannot sell them, you can lease them. But beware of bubble territories such as Elephant and Castle; stick to the deepest, most liquid markets and top locations such as Chelsea, because interviewees anticipate the market becoming overheated.

## Distress: Will They or Won't They?

Opportunity funds have been champing at the bit for the release of assets since day one of the crisis, and the long wait is over. In 2011, the year rounded out with a number of banks placing loans and assets on the market—in billion-sized chunks—from lenders such as Intesa Sanpaolo and Soc Gen. Expect more of this activity in 2012. Almost 60 percent of survey respondents predict that more forced sales will be forthcoming over the coming months: the most optimistic are those from the United Kingdom, Spain, Portugal, France, Greece, and Ireland.

Pressures placed on banks by the sovereign debt crisis and the need to secure Tier 1 capital requirements by June 2012 have certainly greased the wheels—as has the fact that many banks now have the necessary people and platforms in place to process the backlog. But interviewees also believe that although working with borrowers to create value and then exit once that value returns had been a viable strategy before, the realisation that values are now unlikely to come back in the near future means holding on to some situations will become pointless for banks.

"Banks were waiting for a better day. There isn't going to be a better day. They are now selling problems—assets that need money and management. But we are also starting to see portfolios of nonperforming loans being sold. The extend-and-pretend era is coming to an end." Whether the anticipated "flood" of assets will occur is another question.

Banks argue that the pace of releasing distressed assets is unlikely to change, because not many buyers have the right skills to take on the assets that banks need to sell—that is, those that have the cash, experience, connection to debt, and platforms to work with it properly. "The whole thing is based on the false premise that there is capital. Even the hedge funds need to borrow." "Generally speaking, those who want 20 percent IRRs [internal rates of return] have to leverage what they buy," said one banker. Nonetheless, the move by the Chinese Investment Corporation to back Blackstone's investment in RBS's loan sale and the involvement of institutional equity in the Bank of Ireland sale of a €1.1 billion loan portfolio to Kennedy Wilson have inspired confidence that equity to undertake these deals could be forthcoming in 2012.

What became clear during interviews was that access to distressed opportunities differs between countries across

EXHIBIT 1-10

### Real Estate Asset Sales Forced by Lenders in 2012

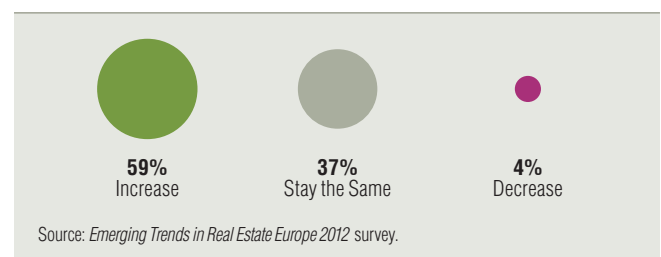
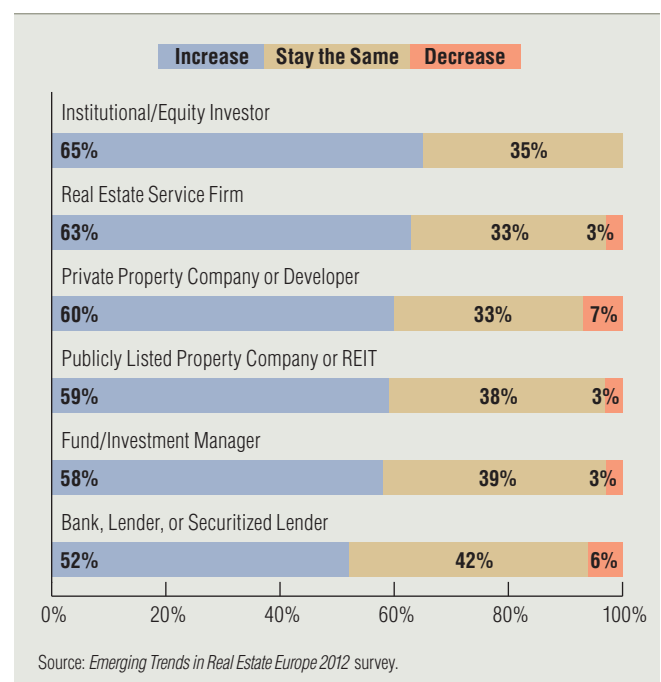


EXHIBIT 1-11

### Views on Real Estate Asset Sales Forced by Lenders in 2012, by Business Type



the region, so generalizing about the deleveraging process was difficult. Increased asset sales from Ireland's National Asset Management Agency, French banks, and Spanish banks (which are described as "definitely prepared to discuss distressed pricing") were punted to be a good source of distressed property in 2012, as well as banks that have loans in noncore markets. But both bankers and borrowers believed that the U.K. banks were unlikely to up the pace because they had been steadily releasing assets to the market for a while. Interviewees widely believed that German banks would continue to "deny" their problems throughout 2012, however.

So strategies may change, but the big question is still pricing. Will the prices that investors want to pay and what banks need to sell at converge? Compromise is expected to be a theme for 2012, but opportunistic investors are adamant this will not involve a meeting of minds. "Convergence on pricing will happen, but it will have to be banks coming down on price rather than investors paying more," said one. Said another, "We still view that investor return mandates of between 20 percent and 25 percent are achievable through buying opportunities in the debt market."

Is this misguided? Research from DTZ does not support the optimism. Although funds that have been raised for distress are seeking discounts of 60 percent and more, recent sales of loans or assets have attracted much smaller discounts of around 30 percent.

Moreover, pressures to invest capital could play into the hands of banks. "I can see convergence on pricing being a trend in 2012; investors have come looking for 20 percent returns and banks have been saying 'no way.' That equity has gone away and still not found anywhere to invest, so there may be more desperation on both sides to get a deal done now."

It is not just asset and loan sales from the banks; investors expect rich opportunities from the following quarters in 2012:

- Increased opportunities to buy "zombie-fund managers," which after six years of tough capital-raising markets and no fresh capital on the horizon, find themselves cut loose by limited partners.
- Opportunities to invest in prime assets with tired owners behind them. "People struggled through the credit crunch and now realise they need expertise or help. It is not a good time to sell, so ... we can help by becoming direct secondary investors and buying partial interests from investors so they can recapitalize. The name on the door may be the same, but the people behind them could be anyone these days."
- Property released to the market by over-indebted corporates to free up capital. Alternatively, increased merger and acquisition activity in the financial and insurance sectors could create a surplus of real estate on balance sheets that will then be sold to create liquidity.
- Asset management opportunities for those prepared to put 100 percent equity into a deal. Investors are seeking to team with those who have land or buildings in need of new capital to help restore or re-lease a property.

## Above All, Love Your Occupier

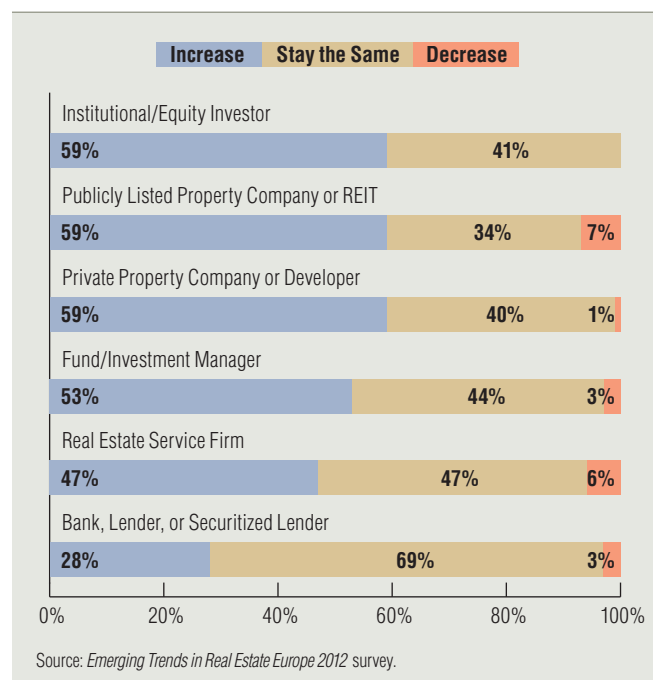
In the occupational markets, 2012 will be a year when tenants find they are able to gain increasingly good deals as landlords go to even greater lengths to keep buildings occupied, and long term, demand patterns will be based on doing more with less space. Interviewees identified significant changes in tenant behaviour as 2011 came to a close in relation to both new and existing leases, and these changes are not expected to reverse in 2012.

When it comes to new demand, there is very little confidence. Occupiers across all sectors were reported to be unwilling to assume growth within their own businesses. "Confidence is so low that occupiers don't know what their requirement might be in two years. Unless you give them a compelling reason, they won't make a decision. Every occupier we speak to is the same. It isn't that they think they won't be around but that they don't know what size or shape they will be in," said one interviewee. Therefore, activity that does happen is likely to be defined by drives towards greater efficiency, and this is likely to mean less but more efficient high-quality space.

In the retail sector, fewer but larger units are preferable even for those companies that are trading well. Landlords reported tenants seeking different space as they rationalised their portfolios—partly as a function of the increasing pressure of the internet and partly as a function of the need to be in the best location possible. "The marginalised retail offer will become irrelevant; there is no demand. The number of shopping venues

EXHIBIT 1-12

### Views on the Impact of Sustainability on Real Estate Businesses in 2012, by Business Type



## Demands for the Future

Interviewees say a key emerging trend will be the need to pay increased attention to societal and consumer needs as a way of securing long-term income. “The future is all about investing from the bottom up. Tactical decisions must be informed by strategic views of what people really want.” Here are some of the key forecasts:

- As technology and media occupiers edge out financial services as the most active occupiers in major European cities such as London, building design will pay greater heed to the need to inspire creativity. “For firms like Google, they don’t just want a box, they want an environment.”
- Stores will serve a retailer’s

business on the internet, rather than vice versa. “Retailers now need a sophisticated multichannel response.” Shopping centres will become meeting places for people and “more and more of a showcase.” Therefore, shopping centres of the future must be sustainable, the outdoor space of quality, and the interior use flexible.

- Major corporate occupiers will seek to work with developers in a consortium to co-occupy buildings as a way of securing better buildings, allowing them to occupy less but better-quality space. “We want our buildings to work harder. We want sustainable space,” said one.
- Providing sustainable buildings will involve more than supplying an

energy-efficient building. Developers and occupiers both believe the future is about educating tenants on how to occupy a building more sustainably, which will extend to providing travel plans around shared cars, taxis, and bicycles. “It is not just about offering value in the building but also about helping them to achieve higher retention rates for their workforce, which is a critical issue.”

- As the world becomes increasingly complex and stressful, customers will demand better-quality office space. The next cycle will be a human resource cycle. “We think workers will demand better working conditions to cope with the additional pressure of modern society.”

needed will be fewer, and the ones that are good will be valuable and rents will go up.”

In the office sector, sustainability is becoming essential to occupiers that are making moves in 2012, and as predicted in last year’s report, the economic climate has only heightened the focus on sustainable buildings for large office occupiers. These firms see it as critical to retaining shareholder value and a positive for the perception of their brands. But occupiers are also looking for safe havens, and sustainability is viewed as a way of increasing efficiencies and cutting costs long term.

“If a building is well occupied, it will remain let and retain value, keeping its competitive edge over other buildings.” “We have become even more focussed on sustainability,” said one fund manager. “We are trying to do everything we can to become proactive rather than reactive in this sense.”

In general, however, where occupiers do commit to new space or lease renewals, those commitments are for shorter periods.

Bankers interviewed reported that their borrowers were being forced to increase rent-free periods during the last half of 2011. They fear the biggest problem for their borrowers in 2012 is not necessarily tenant failure but tenant attrition across all sectors. “We are seeing landlords increasing the rent-free periods for up to two years on a five-year lease. That is how bad it is getting. Back in 2006, you probably got away with a six- to 12-month concession on a 15-year lease.” In addition to rental concessions, landlords will be required to invest into a property to secure a lease renewal. “Next year, leasing deals will be less landlord friendly. That will take time and confidence to reverse.”

“The landlord can’t maximise the value of the asset but he doesn’t want a vacancy either. So in a lot of cases, landlords are holding on,” reported one lender. “The only single tenant restructuring we have been able to negotiate involved extending the lease for five years, with a three-year break, the first year rent free as well as the fourth if they opted to extend. A five-year tenancy for three years at no rental increase: that is the future of the business in a nutshell.”

As a result, interviewees report increasingly proactive day-to-day management that involves working with tenants by exchanging cash flow for security. “Indexation in France had pushed rents up, so what we have been doing is sitting down with the tenant and asking them what we can do—offering lease breaks, rent decreases, anything that gives us more security.”

## Business Prospects: Profitability

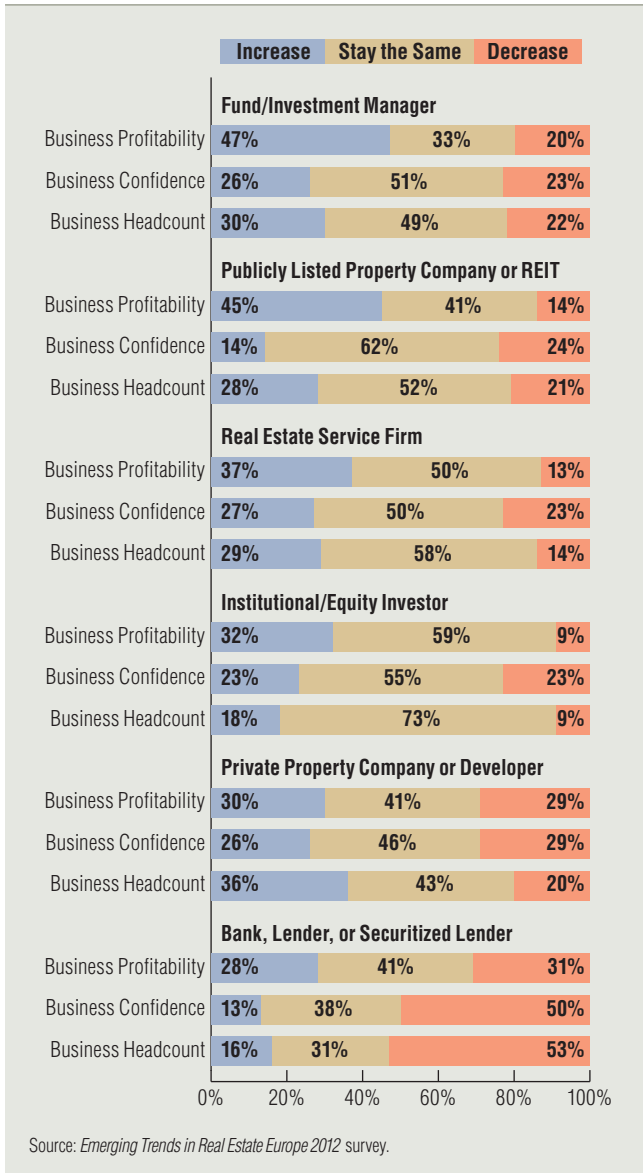
In light of the increasing distress in 2012, it is no surprise that the most pessimistic specialists were bankers. More than half of bankers thought that headcounts would decrease in 2012, and a similar proportion expected their business confidence to decrease also. Almost three-quarters thought profitability would decrease or stay the same.

Private property companies and developers were also at the lower end of the scale on questions about expected profits and business confidence, with just under a third reporting that profits would increase. Low demand and lack of funding will mean developers are forced to stay bored or adapt. “There is absolutely no credit. Even if we have a prelet to a great



EXHIBIT 1-13

## Views on Real Estate Business Prospects for 2012, by Business Type



tenant, banks can't fund it on their own." Thus, 2012 is about either taking on the best projects in a given city or not doing anything at all. Expect to see some businesses refocusing, working on facilities management or working with capital to develop investment strategies for it.

Fund managers were among the most optimistic about business prospects in 2012. Almost half believed profits would increase. Their optimism is explained by the fact that although raising capital is difficult, healthy fund managers have undergone the debt restructuring that they need to and have been nurturing relationships with investors for some time, meaning they are in a good position to withstand further volatility. Some also put forward the argument that prime, core real estate

offers a safe income return compared to other asset classes, which in a low-interest-rate environment is attractive to investors. In the interviews, however, the mood was more modest, especially concerning the prospects of those who have not yet undergone the restructuring they need.

Europe will be a tough sell philosophically for capital raisers, as assets in growth markets in China, Singapore, Taiwan, and Brazil are considered must-have, high-return locations. (New capital for investment in property markets globally fell 4 percent in the first half of 2011 to US\$316 billion, according to DTZ.)

Moreover, uncertainty over the European Union's Solvency II Directive, the reform measures of Basel III, and the Alternative Investment Fund Managers Directive as well as the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act will continue to complicate matters. "We need a clear view, and I don't think that will happen for four years."

Fund managers were also wary about the long-term prospects for their industry. Only the best—with the brand and reputation—will attract the equity necessary to fund the higher costs and hurdles associated with running these businesses. New ventures will be starved at birth. These are both features of the business that will continue for some time yet. "There will be more deaths this year than last, and there's more coming in 2013. Three years from now, if we have half a dozen who are managing European funds between €500 million and €1 billion, I would be surprised."

Real estate service firms had modest outlooks for 2012, with expectations that transaction and leasing businesses are expected to be slow, as well as valuation work (which needs healthy banks to function). However, they believe stagnation in Europe will be offset by activity in Asia, and corporate occupier work will keep them busy.

Real estate investment trusts (REITs), SIICs (*sociétés d'investissements immobiliers cotées*), and publicly listed firms were widely perceived to be the strongest and biggest winners this year. Responses from these firms over their own business prospects would seem to agree. In charge of healthy balance sheets, they are also one of the only investor groups with an ability to access a wider range of debt finance (such as raising equity from shareholders or the corporate bond market), and 45 percent expect an increase in profitability in 2012.





# Real Estate Capital Markets

“Even with an orderly solution, the prospects are not good.”

The near-term future for the real estate capital markets has rarely been more uncertain than it is today, owing to both the continuing financial crisis and the introduction of new financial regulations. When the interviews for this report were conducted during November and early December 2011, the future of the euro was hanging in the balance, with several countries within the Eurozone facing the possibility of ejection from the single currency. A number of interviewees took the view that although they could not see the euro collapsing, the situation had rapidly become a case of the politicians versus the markets. As one commented: “The politicians want to edge slowly through to a solution. The challenge is that the markets are not giving them the time.”

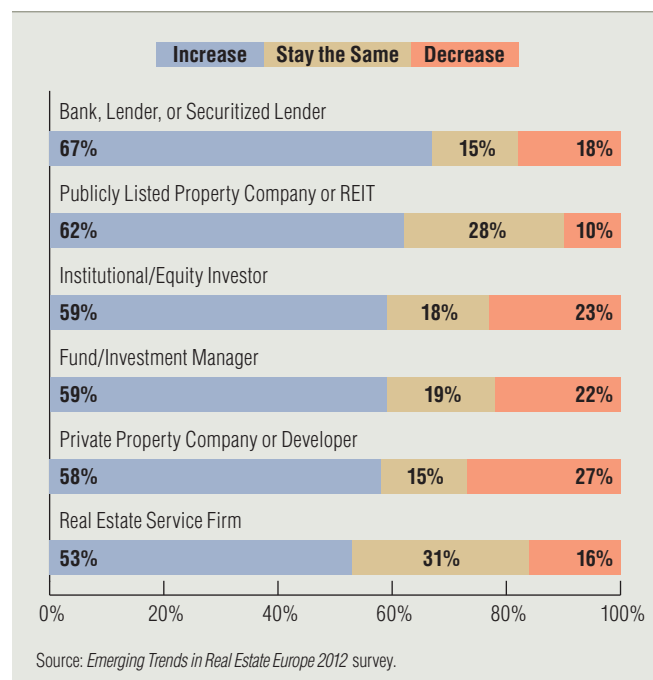
## Paralysed by Economic Uncertainty

Many of those interviewed described the difficulties that they were having modelling the possible scenarios for the euro and how that would affect their businesses. None provided a particularly appealing outcome. As one interviewee noted: “Even with an orderly solution, the prospects are not good. Our most optimistic scenario is zero growth for many years to come, with a significant possibility that it could be very bad or even worse. We could see a major recession across Europe. This is going to be as bad as the period following the Lehman collapse.” In addition to the consequences of economic stagnation for the occupier side of the equation, which are discussed in chapter 3, the profound economic uncertainty is affecting providers of equity and debt directly. Three

years after Lehman, the uncertainty over the level of banks' exposure to sovereign debt default coupled with uncertainty over the regulatory changes introduced as a result caused significant elements of the capital markets to be reduced to a

EXHIBIT 2-1

### Views on the Impact of Sovereign Debt Crisis on Real Estate Businesses in 2012, by Business Type



state of almost total paralysis. This doubt dramatically affected the pricing and availability of interbank lending, which had an immediate knock-on effect for borrowers. As one London-based manager commented, “Everything denominated in euro causes a frisson of terror.”

The other consequence of the financial instability since 2008 has been its role as an impetus for massive regulatory change, the likely effects of which are now starting to become apparent. In the aftermath of the 2008 financial crisis, the G20 has become an important engine for setting the direction of postcrisis regulatory reforms that national governments, policy setters, and regulators are following when they develop domestic reform packages. The G20 was squarely faced with the deepening European sovereign debt crisis at its November meeting in Cannes, which was also part way through the interview process for this report.

## The Growing Burden of Regulation

Interviewees broadly acknowledged that the impact of regulation on the real estate industry will be huge. The volume of new rules slated for introduction in 2013 and 2014 is unprecedented. The sense of frustration of some interviewees was palpable. As one French interviewee noted, “We are creating numerous regulations, which, each time, lead us one step closer towards absurdity.” Not everyone felt that the message was getting through. One London-based fund manager commented, “Regulation will become more of an issue and I don’t think that the private equity market has grasped it. The REITs [real estate investment trusts] have, but our lot haven’t.”

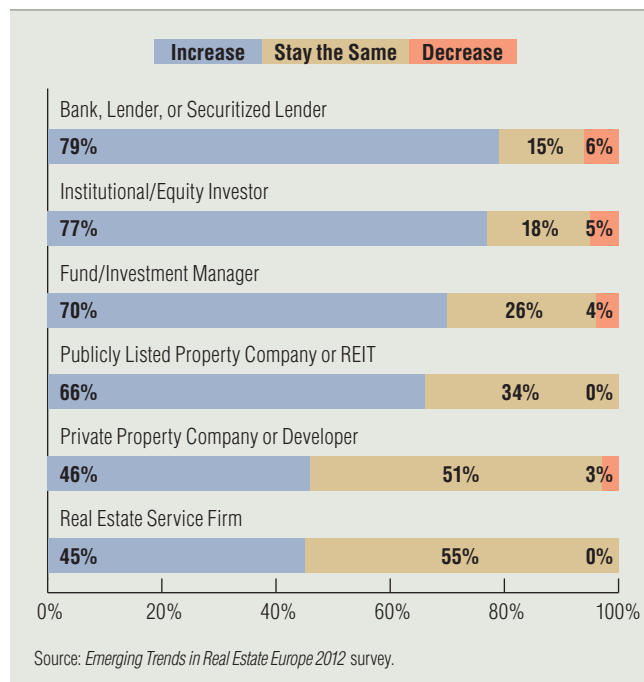
The European Union is driving regulation. Interviewees from outside the EU, particularly from Switzerland, tended to take a more relaxed view. As one Swiss interviewee commented, “Regulation is currently not a big problem in Switzerland.” Another observed that regulation is “a growth market in Europe.” Referring specifically to the structural problem of German open-ended funds, one Swiss investor stated that “in terms of regulation, Germany is Europe’s grand sick man.”

Not all those interviewed saw the increase in regulation as negative. As an interviewee from a pension fund commented, “An increase of regulation is a blessing rather than a curse for the market, because it can reveal the ‘bad apples’ in the market.” Another interviewee stated that “regulation will separate the sheep from the goats.” Some interviewees from larger fund managers also saw regulation as providing them with a competitive advantage over smaller players in the industry. Among survey respondents, those that foresaw the greatest increase in regulation were banks and lenders, institutional investors, and fund or investment managers.

Three changes in particular were cited time and time again by interviewees as a major source of concern: Basel III, Solvency II, and the Alternative Investment Fund Managers Directive (AIFMD).

EXHIBIT 2-2

### Views on the Impact of Regulation on Real Estate Businesses in 2012, by Business Type



**Basel III.** The Basel Committee on Banking Supervision had released its long-awaited proposals to strengthen existing Basel II global capital rules on 12 September 2010, immediately prior to the interview period for last year’s *Emerging Trends* report. After a year to contemplate the impact, Basel III is clearly much higher on interviewees’ agendas this year. Furthermore, the European Banking Authority published its 2011 *EU-Wide Stress Test Aggregate Report* in July and the EU measures to restore confidence in the banking sector in October. The regulation of the banking sector was also a key element of the Cannes G20 summit. The G20 leaders agreed that the rules must be implemented in a coordinated and complete manner, including Basel II implementation where it has not previously been applied, enhanced capital requirements on market and securitisation activities under the so-called Basel 2.5, and the new capital and liquidity rules and leverage ratios under Basel III. To hit the higher capital ratios, banks will be faced with two choices: increase capital or reduce assets.

As one French banker commented, “In terms of financing of the real estate industry, it is not a liquidity problem as in 2008/2009 but an equity problem triggered by Basel III. A Tier 1 ratio of 9 percent to be reached before end of June 2012 means that banks are unloading their asset base, real estate being a marginal activity for most of the big banks.” The Tier 1 ratio will continue to rise over the phased introduction period of Basel III. One London-based banker summed up the situation as follows: “Capital required to set against assets



has gone from 2 to 3 percent in the boom years to around 11 or 12 percent by 2019. So capital increases mean two things (1) do less financing going forward and (2) margins will have to be very considerably higher. At a time when shortage of debt financing is a major issue, this combination is almost untenable." A German mortgage lender commented, "The choice you have is either to increase equity or to reduce the balance sheet total, which is the choice between Scylla and Charybdis."

"There is a huge gap between the amount of debt that needs to be refinanced and the amount of debt available from the banks to do the job. The impact of Basel III is potentially huge—so huge, in fact, that I think that it will be watered down at the last minute. There is not enough equity to bolster the banks, so they will have to sell vast quantities of assets to meet the regulatory requirements. This will reduce asset values, which means that they will need to sell more assets. Some solution will be found that will allow the banks to extend and pretend for a bit longer."

One banker summed up the broader impact of Basel III: "It was right for regulators to consider how banks functioned. But now you reap what you sow, and if you want safer banks, then this has implications in the wider economy."

**Solvency II.** Those interviewed for this report widely recognised that the implementation of the Solvency II regulations for European insurance companies is of huge significance for the real estate industry. Life insurance companies are major investors in real estate as an asset class. Furthermore, the European Insurance and Occupational Pensions Authority has started a consultation process due to be completed in January regarding the extension of a Solvency II-type regime to some or all defined-benefit pension schemes. Such a regime will potentially have an even greater impact for the real estate industry than the application of the rules to insurance companies.

The key concern for the real estate industry is how insurers and possibly pension funds will view real estate as an investment asset once Solvency II is in force, and in particular, how they will be required to model potential future falls in value of their investments. One interviewee commented: "As an insurer, we are going to be directly impacted by Solvency II. It is not great for direct investment, but the treatment of funds looks as though it is being clarified in a way that works for us, mirroring the treatment that we already adopt. We are worried about the modelling of currency risks and that this might encourage people to stay at home rather than investing abroad. As a big insurer, we are going to be using our own internally generated model rather than the standard model set out in the regulations. All this means less change for us."

Not all interviewees saw the increased pressure on insurers as a negative. As one Dutch investor observed, "Solvency II will take money away from the equity market. This is a plus: despite the meagre economic outlook, there is too much money chasing too few deals, resulting in high prices."

## Alternative Investment Fund Managers Directive.

The AIFMD will make real estate fund management a regulated activity in the EU. A major step forward on this front occurred during the interview period for this *Emerging Trends* report. The European Securities and Markets Authority published on 16 November 2011 its long-awaited final technical advice that will implement the AIFMD, which is a significant milestone in the progress of the legislation. Although not required to adopt all the technical advice, the European Commission is expected to follow it closely in developing the implementation measures.

Interviewees generally regarded the AIFMD's impact as of major importance but slightly less critical than the changes affecting banks and insurance companies. As one interviewee commented: "Solvency II is potentially game changing. Everything else is just a big hassle. Life is increasingly full of pointless hassle, and this is just another example. Nobody can get a competitive advantage from this; it just drags everyone down together."

Not everyone agreed that no opportunity exists for competitive advantage. A number of interviewees from businesses that are already regulated felt they would be able to cope more easily. As one put it: "Regulation will be a huge issue for the real estate industry. Direct regulation, in the form of the AIFMD, is probably a competitive advantage for us. We are part of an insurance company, so are already used to a heavily regulated environment and have the infrastructure in place to deal with regulation. For others from an unregulated world, this is going to be a real challenge." Another interviewee noted, "Larger players should have a competitive advantage due to scale, and this is likely to lead to consolidation in the industry across the EU." The consequence of this advantage was also remarked on by others, a Dutch interviewee commenting, "The administrative burden of the AIFMD will prevent new creative start-ups and kill small niche players: in ten to 15 years from now, the fund management business will consist of only larger managers, all providing the same uniform services. It will kill the fun in exploring new ventures."

## Availability of Debt

After a period that one interviewee described as "the banks have just been kicking the can along the street," interviewees gave a very definite sense that a major change is underway, both in terms of the restructuring of existing debt and for the provision of new debt.

As far as new debt is concerned, those interviewed or those who completed the online survey showed little optimism. The overwhelming consensus among survey respondents is that debt will be less available in 2012. A small minority took the view that debt would be more available, but this view was not shared by lenders. No lender thought that more debt would be available, and only 6 percent thought the availability of debt would even remain the same. The remaining 94 percent

were equally divided between availability being “moderately less” and “substantially less.” Clearly, borrowers and lenders will need to adapt to an environment less dependent upon leverage. The view of interviewees was that the downturn in lending has already occurred and that a significant change had taken place during 2011. As one fund manager observed: “There is no debt. The debt markets are toast. Horrendous.”

The overwhelming consensus view was that underwriting standards for debt would become more demanding. Of respondents, 85 percent thought standards would become more rigorous, and only 13 percent believed standards would remain the same. Only 1 percent believed standards would become less rigorous. Again, the view from interviewees is that this process is underway. As one borrower noted, “Banks are increasingly difficult to deal with, and the process to obtain financing is becoming harder and more complicated.”

A number of interviewees were of the view that the market had very much become one where what lending there is will be only to existing customers with strong relationships, primarily to refinance or extend existing positions. Those in such a position retain their confidence. As one fund manager commented: “We have always borrowed from German banks and regarded them as relationship banks over 15 years. Our two banks have remained loyal to us and renewed what we have asked them to, including Greece at current market terms.” However, with some banks announcing their complete withdrawal from commercial real estate lending and others very significantly curtailing their lending, a significant risk exists for borrowers that their strong relationship may be with the wrong bank. If that is the case, then finding a replacement lender may be hugely challenging. One borrower observed: “We found only two banks genuinely open for business. If you are not lending to institutional funds buying decent, multilet assets with 60 percent LTV and a manager you have known and done business with for 25 years, getting yields well above the cost of debt, then you are not really in the lending business.”

Borrowing in Greece, Italy, and Portugal will be particularly challenging, according to survey responses. Interviewees were also not optimistic about the prospects for Spain and Ireland. Domestic lenders in all of these countries are generally in more dramatic difficulty than lenders elsewhere in

EXHIBIT 2-3

### Availability of Debt Capital for Refinancing or New Investment in 2012

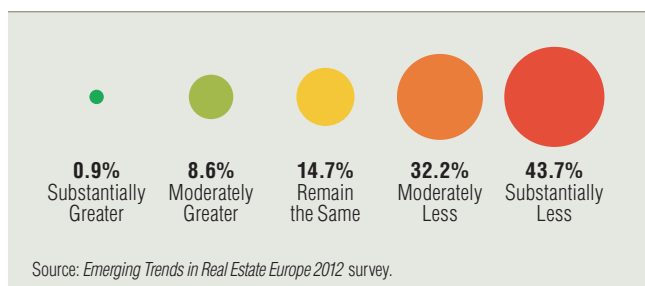


EXHIBIT 2-4

### Views on the Availability of Debt Capital for Refinancing or New Investment in 2012, by Business Type

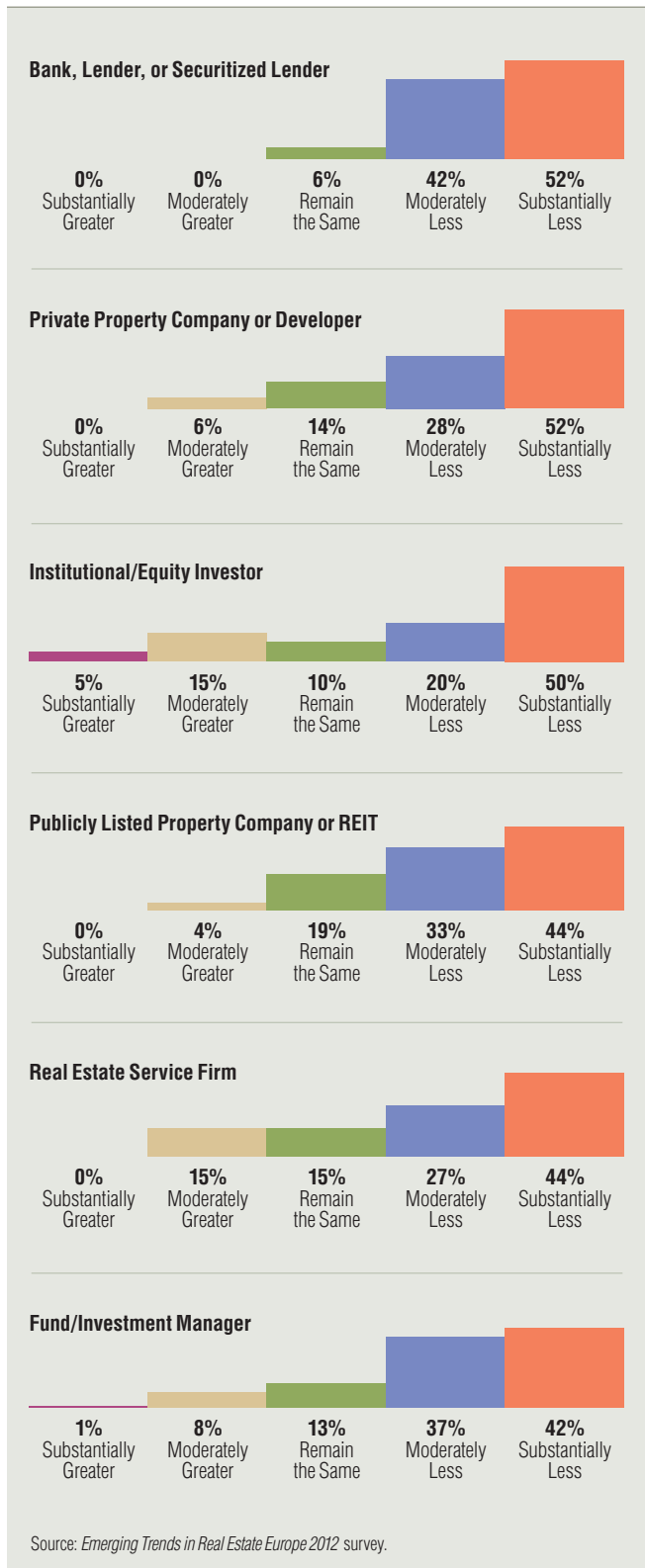
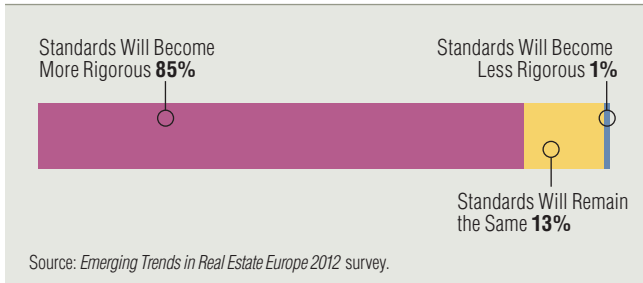


EXHIBIT 2-5

**Debt Underwriting in 2012**

Europe, and international lenders are retreating to their home markets. One Spanish interviewee described the approach of the banks in Spain as “financial strangulation.”

But the problems are widespread, and lending will be curtailed throughout Europe. Many interviewees in Central and Eastern Europe (CEE) were particularly nervous about the availability of debt, citing the concern that German and Austrian lenders, who had been very active in the market, were curtailing their activity. One borrower commented: “Everything we heard four years ago is coming to pass. Austrian banks have been told to stop lending to CEE. Last year’s good news seems a long way away. The crisis is back with a vengeance.”

Many interviewees commented on the likely behaviour of German lenders. The announcement in November that Eurohypo had been told by its parent, Commerzbank, to cease lending had come as a shock to some interviewees whilst others felt that this situation had been foreseen for some time. Either way, that and other decisions taken by the German banks were widely seen as highly significant because they had been such active lenders across Europe. A typical comment from an interviewee was, “Banks that can raise money on the Pfandbrief market are still active, but not like they were before.” The view among interviewees, including the lenders themselves, was that they would be retrenching heavily and what new lending they did would concentrate on core assets in Germany.

This situation was a concern not only to borrowers elsewhere, but also to some German lenders themselves who saw a risk of banks all wanting to lend on the same narrow band of assets. As an interviewee from one German bank noted, “Most of our competitors are closing down their international business or at least downsizing and refocusing on the German market, so we expect stronger competition in our core German segment.” This is a positive development if you are an equity investor looking to buy core German assets with low levels of gearing but is less good news for everyone else.

Debt is going to be not only in short supply but also expensive. The financing cost for banks has risen significantly, even without the capital cost of meeting regulatory capital requirements. The dramatically increased cost to the banks is being passed on to borrowers, resulting in what one inter-

viewee described as “eye-watering margins” over base rates. Interviews with borrowers and lenders alike suggested that these costs are unlikely to decrease in the short term.

**Deleveraging.** As already discussed, banks are subject to very significant regulatory pressure to reduce their assets to meet capital requirements, and the view is widespread that commercial real estate lending will be disproportionately hit by this asset reduction. Whilst some interviewees believe it will release a torrent of opportunity, others are more sceptical. The banks face a dilemma. As one lender said, “We cannot just dump assets because it would create a self-perpetuating downward spiral. The numbers are enormous.” This sense of caution is reflected in other interviews with bankers. One interviewee from a bank in the midst of an active deleveraging programme commented as follows: “My view is that you have to be cautious because although we will have short-term dark spaces over the next six months, things will recover. There is sufficient activity that will keep the market moving. I would be cautious about next year, but I think we still have the ability to sell throughout the year.” As one investment banker summed it up, “The trickle will increase in pace, but there will be no tsunami.”

The banks are only part of the lending pool that needs to deleverage. The issuance of commercial mortgage-backed securities (CMBS) peaked in Europe in 2005, 2006, and early 2007, the top of the boom market. Although CMBS were never as dominant a part of the market as in the United States, these peak-of-the-market CMBS issuances are now moving towards maturity. It is also worth remembering what went into CMBS conduits at the time. As the 2007 *Emerging Trends in Real Estate Europe* report noted, 2006 issuance was marked by a more mixed bag of property finding its way into the CMBS pool, with one 2007 interviewee commenting, “I think there’s a lot of mispriced paper floating about.” Much of this 2006 CMBS debt is due to reach maturity in the next three years. As one lender observed, “The CMBS maturities will start to trickle out next year, but the fortunate thing is that the bondholders will take a hit on that, not the banks.” Interviewees closest to the epicentre tended to be more sceptical that the unwinding of CMBS positions would result in a flood of assets onto the market. As one commented: “I think that many of the CMBS issues will also be worked through. Although it is a lot more complicated than bank lending, many are being worked through and bonds extended. We are bondholders in a number. Although some may fail, it will be a minority.”

Several interviewees identified an issue that has been restricting and may continue to restrict the banks from taking action: the impact of break costs for interest-rate swaps. The fall in variable-rate interest rates has left swaps into fixed rates out of the money. The prognosis of low interest rates for the foreseeable future means that little prospect exists of this reversing, leaving borrowers facing significant break costs. This has been accentuated by borrowers’ widespread prac-

EXHIBIT 2-6

## Views on the Availability of Debt Capital for Refinancing or New Investment in 2012, by Country or Region





tice at the peak of the market of agreeing to enter into swaps that are longer than the life of the loan, sometimes by a significant period. Furthermore, some closed-end funds entered into swaps that are longer than the life of the fund. Lenders are reluctant to take action that would trigger break costs and losses, particularly as the beneficiary of the upside is often not the original lender.

**The Opportunity.** The process of deleveraging coupled with an environment in which new debt will be significantly less available creates opportunities both for those with equity to deploy and for those who could potentially become new providers of debt. As one equity investor commented: “Borrowing is hugely challenging at the moment, and the banks are under massive pressure to offload assets. We do not rely on leverage to buy assets, although we do look at existing debt as an asset when the opportunity arises. We see debt as a strategic tool rather than a way to generate returns. The current issues affecting the banks are an opportunity for us in two ways. Firstly, we think that there will be a significant increase in the rate of disposals by the banks, particularly of loan books. This is a market in which we can participate. The pressure on the banks is also reducing the amount of available debt in the market. This impacts more dramatically other buyers who are more reliant on debt than us. We see a market in which the lack of availability of debt and the pressure on banks create both a buying opportunity and a reduction in the level of competition.”

Consensus was almost universal among those interviewed that the pressure on the banks would create opportunities for others to become providers of debt. However, significant differences of opinion existed as to the detail: who, how much, when, and on what terms?

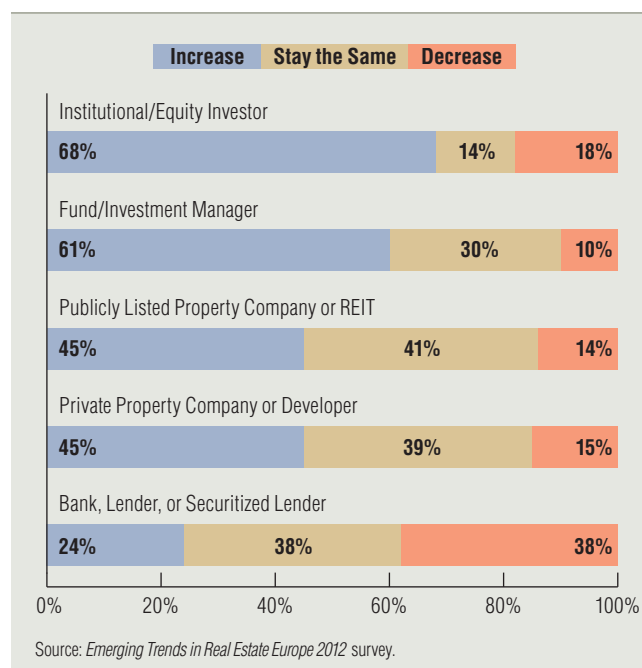
**New Sources of Debt.** In the opinion of many of those interviewed, the most immediate opportunity appears to be the provision of mezzanine debt. The retreat of the banks is opening a gap in the capital structure. When senior lenders were providing debt at 80 percent or even higher LTV, few borrowers needed mezzanine debt. Risk aversion and regulation pushing banks down to LTVs of 60 percent or lower are creating an opening. Interviewees, including the mezzanine providers themselves, cited two major concerns. First, the mezzanine lenders need active senior lenders behind whom to provide mezzanine product. Several of those interviewed expressed the concern that the retreat of the banks could turn into a rout, leaving the mezzanine lenders in an exposed position rather than tucked into a snug gap in the capital structure. The other concern is pricing. If return expectations for equity are falling, then the population of potential mezzanine borrowers will also decline unless mezzanine expectations are reduced correspondingly. If not, the main role of mezzanine and preferred equity will be in restructuring situations where the borrower has little alternative.

One interviewee summed up the situation as follows: “I see it as ideal for closing the gap in a bull market. I don’t know why if you are a borrower, you want to take on that sort of risk given general lack of clarity in the market. Most activity is focused on people who are desperate. You don’t do mezzanine unless you are very clear of the outcome, and it is not easy at this juncture to be clear of the outcome.” The other comment from a number of interviewees is that the amount of capital raised to provide mezzanine finance is relatively small, particularly in comparison to the amount by which the banks need to deleverage.

Another major topic of discussion in interviews was new providers of senior debt. A number of large insurers had already entered the real estate debt market during 2011. The view was widespread among interviewees that the number of lenders and the scale of lending would increase; insurers would be attracted by the commercial opportunity provided by the departure of the banks and the benign treatment of real estate lending by insurers under Solvency II. The general view among interviewees, including the insurers themselves, is that the amount available for lending will be significantly smaller than the void left by the departing banks. Insurers themselves held a diversity of views as to the type of lending they would do. Some saw themselves as actively originating lending opportunities whilst others saw themselves lending by participating in larger syndication opportunities. The terms on which insurers would lend were also a matter of debate. The majority view was that the insurance companies would want to provide long-term fixed-rate loans that would better

EXHIBIT 2-7

### Views on Capital Deployed in Real Estate Investments in 2012, by Business Type



match their liabilities. Although borrowers viewed this outcome as undesirable, the view was not universal. “The longer-term nature of insurance lending is more akin to what the market wants and needs than the type of borrowing people were doing in 2002 to 2007.” Both borrowers and lenders also cited instances of insurers lending on more flexible terms.

Interviewees saw sovereign wealth funds, insurers, and fund managers with segregated accounts as being able to participate at all levels of the capital structure—from senior debt to equity—allowing them to forage in the market very efficiently for deals, deciding where in the capital stack to invest for the most attractive risk-adjusted return.

For really solid borrowers, such as some of the larger REITS, direct access to the capital markets to issue long-term bonds has continued through the year, reducing the need for traditional senior lenders. Both borrowers and lenders saw this opportunity as something that would continue in the future. As one banker observed: “We have seen U.S. private placement, convertible bonds, even CMBS this year. We have seen old-fashioned debentures bonds, so [there is] a greater number of products. You need to be a big beast to access it, but that is a trend. There will be a larger range of providers—hedge funds, pension funds; we will see lots of different providers coming into the sector.”

## Availability of Equity

The view of respondents regarding the availability of equity is much more positive; the proportion believing that equity will be more available exceeds the proportion believing that equity will be less available. The most promising aspect is the response from institutional investors: 65 percent believe that equity will be moderately more available, with a further 10 percent believing that equity would be substantially more available. Germany and France both rated highly on the issue of equity availability. The view was widespread that the pressure on investors to invest is increasing, and real estate retains its attraction as an asset class. The need to deploy capital was a view also shared by some of the institutions. As an interviewee from one of the pension funds observed, “The money

EXHIBIT 2-8

### Availability of Equity Capital for Refinancing or New Investment in 2012

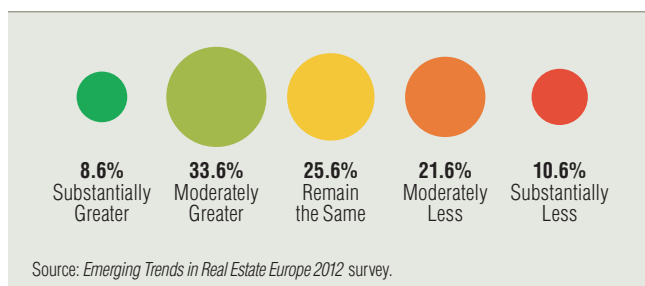


EXHIBIT 2-9

### Views on the Availability of Equity Capital for Refinancing or New Investment in 2012, by Business Type

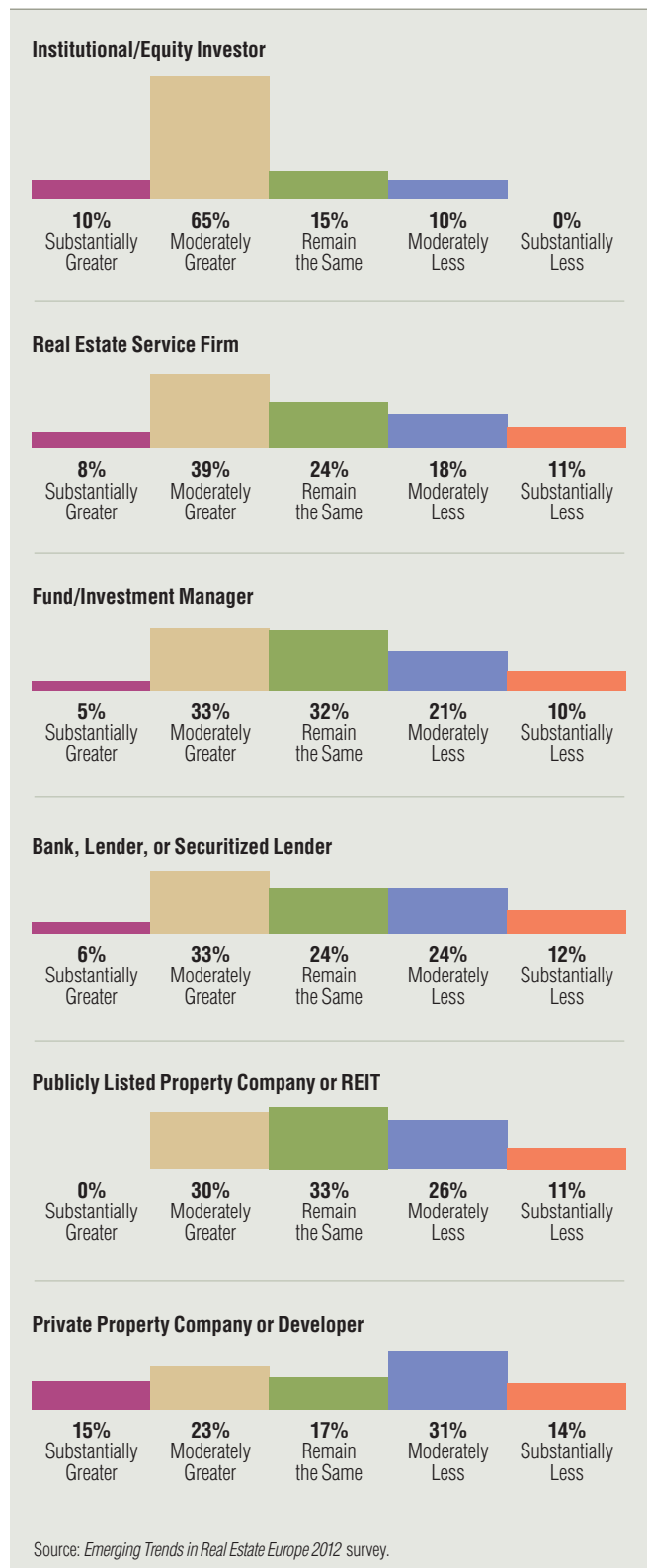
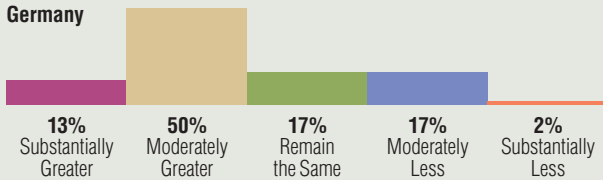


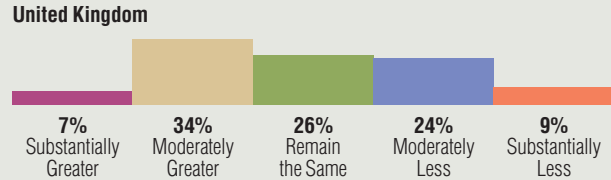
EXHIBIT 2-10

## Views on the Availability of Equity Capital for Refinancing or New Investment in 2012, by Country or Region

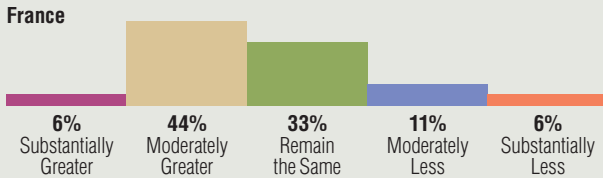
## Germany



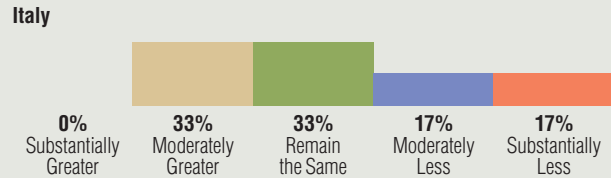
## United Kingdom



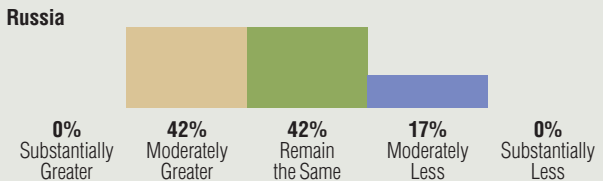
## France



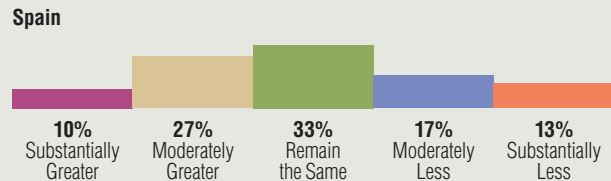
## Italy



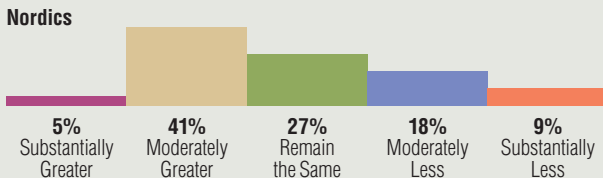
## Russia



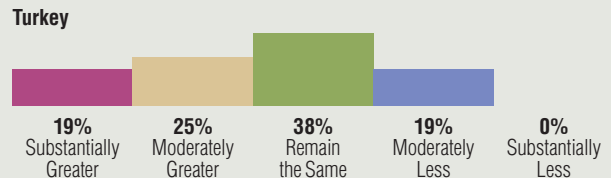
## Spain



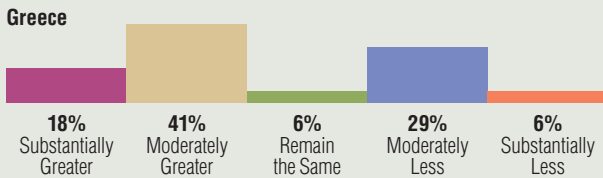
## Nordics



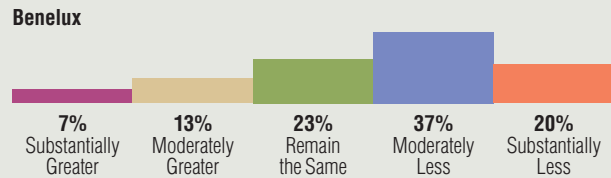
## Turkey



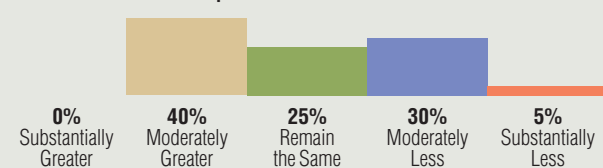
## Greece



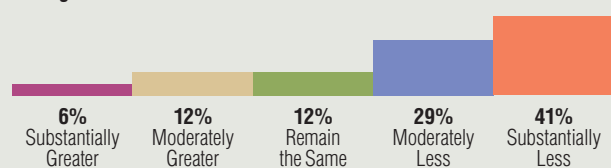
## Benelux



## Central and Eastern Europe



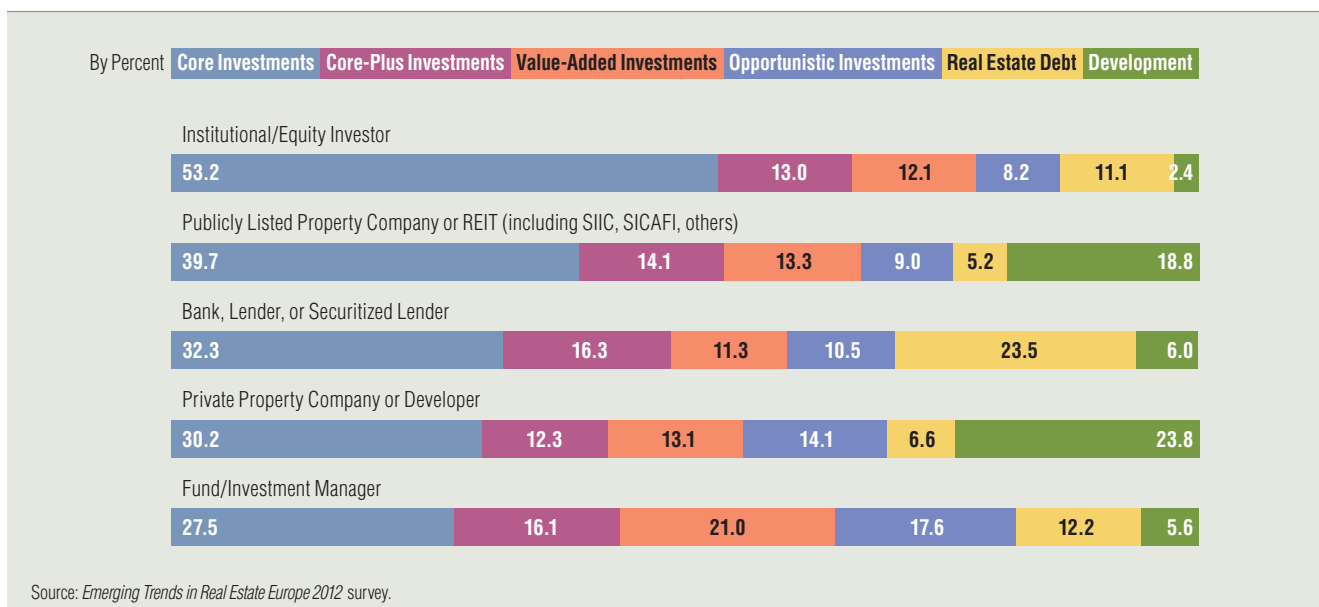
## Portugal



Source: Emerging Trends in Real Estate Europe 2012 survey.

## EXHIBIT 2-11

## Investor Allocation Preferences for 2012, by Strategy and Investor Type



inflow into the pension fund has to be invested somewhere.”

Although the survey responses suggest that equity may be more available, when and how investors will choose to deploy this capital is less certain. As one fund manager commented: “The environment is challenging as investors are using the uncertainty to avoid taking decisions. Investors do not feel under pressure to invest—they think they can wait for the bargains to come along. If everything works out in an orderly fashion, then things will not change for a long time, so there is no need to rush. If things resolve themselves in a disorderly fashion, then there will be a significant fall in values and bargains to buy. There is no penalty for holding on to your cash and the risk that you will miss bargains if you buy too soon. The people who are still investing are the long-term buyers of income.”

The uncertainty regarding regulation was also seen as a major impediment, with one placement agent noting: “For an equity-raising business, regulation is currently a showstopper. The lack of clarity over AIFMD and Solvency II are causing institutional investors to sit on their hands. Raising equity in Europe from institutional investors will be impossible until the regulatory position is sorted out.” A view also exists that the larger investors are moving more rapidly. “There’s a split in the market. Smaller investors do not want to commit long term and thus are standing on the sidelines. Larger investors are increasing their real estate allocation.” As one Dutch interviewee commented: “The current state of equity providers shows that we are poor learners. At the height of the market, too much money was chasing high risk for higher returns when they should have been more conservative. At the bottom of the market, there is too much money chasing low risk for too-high prices while

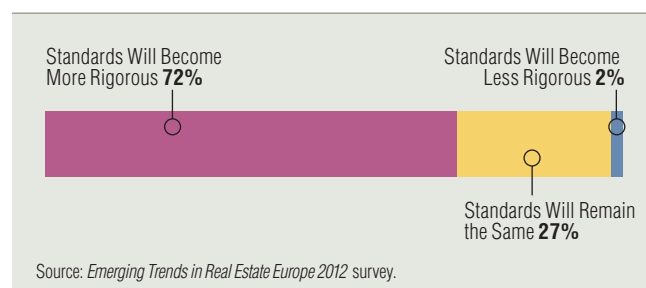
they should be more opportunistic.”

On a less positive note, the long-term impact of the economic malaise in Europe could reduce the equity pool available for investment. The effect of the austerity measures across Europe has yet to fully feed through to retail investors, although some are concerned this is starting to happen. This affects not only fund managers who market retail funds but also retail investment into retirement products that ultimately become institutional capital at the investment level. An interviewee from an insurance company rang the alarm bell: “We are experiencing high surrenders of savings-related insurance policies as well as cancellations of policies due to the inability to continue payments. This is expected to get worse in 2012.”

Investors are becoming more demanding: 72 percent of respondents believe that underwriting standards for equity will become more rigorous. Another 27 percent believe that underwriting standards will remain the same. Only 2 percent believe that underwriting standards will become less

## EXHIBIT 2-12

## Equity Underwriting in 2012





demanding. The impact of more rigorous due diligence by investors was commented on by many of those interviewed. As one commented, “There is a focus on due diligence, analysis, making sure you don’t make a mistake.” Even major institutional investors who already had extremely rigorous standards are felt to have stepped up their processes a level. Risk management is the key area. Is this a structural change? Some of those interviewed believe this is a swing of the pendulum, taking the view that investors are particularly risk averse at the moment but will become less demanding as the market recovers. Others, however, are not convinced. “You see, in particular, bigger investors putting in place structures, and that will not go away and that’s a step change in terms of looking at risk.”

With bond yields at a historically unappealing level, sovereign wealth funds and other institutional investors are chasing income yields. In the past, this would have been satisfied through investment in real estate funds. However, for many of these investors, comingled, blind pool funds are out of favour. These major institutional investors are continuing to look at alternative methods of accessing best-in-class management, hence the flurry of transactions in which sovereign wealth funds and major pension funds pair up with leading real estate fund managers and REITs.

**The Fund Management Business.** Both fund managers and investors recognise that many investors are disillusioned with traditional comingled fund models. The crisis has highlighted shortcomings in both the open- and closed-end fund model. Some of this downside has been in respect of structural limitations. The closed-end fund model has always been inherently risky, rewarded by higher returns when things go well. The model entails inflexibility as to the investment period and the life of fund. The risk is increased by generally higher levels of gearing. However, interviewees recognised that, even within these constraints, many managers have not performed well. As one fund manager commented: “The performance of fund managers has been very disappointing, not only at the asset level but also in terms of expense ratio and the quality of the general partners and management. A number are no longer in existence, but also, there has been a lot of disappointment in terms of the discipline of fund managers—discipline in terms of maintaining strategy, in terms of strategy drift.”

The disillusionment of investors is resulting in a number of challenges for fund managers. As mentioned already, many of the big institutional investors are much more inclined to invest through new types of segregated accounts, club deals, and joint ventures. This situation may provide an attractive opportunity for fund managers, too. As one London-based fund manager commented: “We have a number of clients jostling for segregated accounts and say, ‘It looks like this is overlapping; how about we team up?’ That’s nirvana for us; it

gives balance to the investor pool rather than heavy weighting for one investor in particular. If we can have a conversation with three, we can have a better conversation than if with one.” Even where the vehicle is closer to a fund, the level of discretion for the fund manager may be less than was the case in the past. In the words of one interviewee, “The role of the manager and the investor is changing—what is decided by the manager and what is decided by consensus with investors.”

Investors have also become much more focused on alignment of interest, looking at exactly how much skin in the game the manager has. As one interviewee commented, “Investors want real hurt money from the manager. If it goes wrong, they want the manager to lose more than just its reputation.” The other side of the coin is what happens when the incentive disappears. One investor commented, “Generally we wanted to support management, but we saw the difficulty of maintaining manager focus once the carry had gone and the good people have left. In many cases, the banks became surrogate managers.” Investors have become much more interested in the minutiae of how managers run their businesses. As one interviewee noted: “Due diligence by investors has changed—not so much at the asset level but at the manager level. There is much more focus on the operational aspects of the business. Investors are really looking deeply at real alignment of interest.”

Although much of this comment was in respect of closed-ended funds, the open-ended fund model also displayed its inherent weaknesses in the period of volatility. For some investors, timing is crucial; for others, the open-ended fund is attractive specifically to avoid timing issues. They want to deploy capital for the long term without having it returned to them at the end of the natural life of a closed-end fund. The inherent nonalignment of interest between different types of investors was recognised as an issue both among the institutional investor community and among the fund managers. For those investors who had gone into the open-ended fund model to be able to move capital in and out rapidly, there was recognition that, in many cases, liquidity failed at the crucial moment. For those in closed-end funds, the secondary market provided only very limited liquidity at crucial moments. Within the spectrum of open-ended funds, interviewees for the report particularly highlighted the issues facing the German open-ended funds. Since October 2008, German open-ended funds have been suffering from significant capital outflows of liquidity mainly caused by the withdrawal of major investors, causing some funds to suspend redemptions. A handful are already in the process of being wound up. However, a view was also strongly expressed that German investors remain attracted by the open-ended fund model, and those that perform well will succeed and attract capital away from weaker players in the sector.

Many interviewees observed that not only the fund model, but also the expertise of the managers is under scrutiny. A general theme is the effect of the economic situation on the skill set needed from those investing in real estate. As outlined in chapter 1, economic stagnation means that neither rental growth nor yield compression is likely to be a significant feature of the market, possibly for years to come. To find an angle and make money in the current environment requires deep asset management skills. A number of interviewees used the phrases “rolling your sleeves up” and “getting back to basics.” To achieve this goal, many investors feel they need to invest with managers who are either very big or niche players. As one interviewee commented: “A few big fund managers will dominate. At the other end of the spectrum, there is a clear opportunity for the small managers—niche players will attract interest. However, this is much more credible in asset types where there is a clear specialist skill requirement; niche players will succeed by offering a very specific product. Examples of the asset types concerned are retail, hospitality, student housing, and residential. Possibly industrial, too. Smaller fund managers without a clearly defined niche will struggle, as will the midtier generally.”

However, a significant challenge to being niche is the open question of how small players will cope with the cost of regulation and more-demanding investors. An interviewee from a large pension fund noted: “An advantage of economy of scale is if funds are larger, teams can be formed to monitor different aspects, such as finance, risk management, and regulation. The smaller investment funds do not have the

capacity to form teams for this, but the critical investor will demand that these funds will have such teams that manage these issues.” On the theme of smaller players not having the strength in depth to cover the full panoply of issues, one investor commented: “Some fund managers are good at property but really rubbish at the capital markets side of the business. Often this was the asset managers who turned themselves into fund managers and did not have the skills to deal with the borrowing side.” All of this is creating major barriers to entry. “It is now almost impossible to be a start-up in real estate fund management. The regulators and investors have made it a closed shop as new players will find it almost impossible to comply. Answering the INREV [European Association for Investors in Nonlisted Real Estate Vehicles] due diligence questionnaire as a new business would be daunting.”

### **Publicly Listed Companies and REITs.**

According to survey responses, the listed sector had a good year and is expecting much the same for 2012.

Although interviewees remain confident, the main challenge is that shares are trading at significant discounts to net asset value, restricting the ability to raise capital through equity raisings. The CEO of one REIT commented, “Listed equity is losing out to private unlisted equity. It will not add to transparency.” Another noted, “The current situation in the financial market and listed equity values are an issue and do not allow listed companies to engage new issuing equity at reasonable prices compared to the fundamentals.” This situation is also discouraging the creation of new REITs. It raises

EXHIBIT 2-13

**Business Outlook for REITs**

	2011			2012		
	Increased	Stayed the Same	Decreased	Increase	Stay the Same	Decrease
Business Confidence	14%	62%	24%	14%	62%	24%
Business Profitability	55%	41%	3%	45%	41%	14%
Business Headcount	48%	34%	17%	28%	52%	21%
Capital Deployed in Real Estate Investments	52%	38%	10%	45%	41%	14%

Source: *Emerging Trends in Real Estate Europe 2012* survey.

the question as to what the discount represents. Many interviewees commented that REIT shares are a forward-looking indicator and represent what the market thinks to be underlying property values in six months' time.

The bigger beasts in the listed sector are using their strength to access capital in new ways. A number have undertaken joint ventures with funds, sovereign wealth funds, and other institutional investors. As the CEO of one major REIT commented: "We think that there are good reasons for wanting to access private capital for some of what we do. It is an attractive way for us to share risk and get an attractive risk-adjusted return. We want to do this through joint ventures as access to private capital this way is interesting for both parties." The expectation is that this will be an increasing feature of the market. As has been mentioned previously, the big REITS have also been able to access the debt markets directly.

A fundamental question remains about the role of REITS in the real estate markets. One fund manager summed it up as follows: "There is an opportunity for REITs to move to be more of an income provider to capture the drive for income. However, it is difficult for REITs to change. They employ people, and people are difficult to change." The interviews with the REITS themselves make apparent that views vary on this role. Many believe that significant levels of development activity remain fundamental to the business model. Others see the changing real estate market as an opportunity to change, one CEO commenting, "We are changing the nature of the portfolio to change the nature of the business. The company had been a bit of a hybrid; going forward we are going to be a REIT."





# Markets and Sectors to Watch

“2012 is about staying safe and not straying too far from what you know. But even amid the collective cheer for safe havens, dissent exists.”

If Italy defaults on its debt, what happens next and how much would it cost? As 2011 drew to a close, and Italy's cost of borrowing pushed the 7 percent barrier, that question was on people's minds. The truth is nobody really knows what would follow if Europe's fourth-largest economy is unable to service its €1.9 trillion of debt. It is just one of the many unknown outcomes the region could be facing in 2012. Greece could exit the euro, and it might not be the only one; harsh austerity measures, inflation, new currency blocs, and recession—all of these scenarios are on the table.

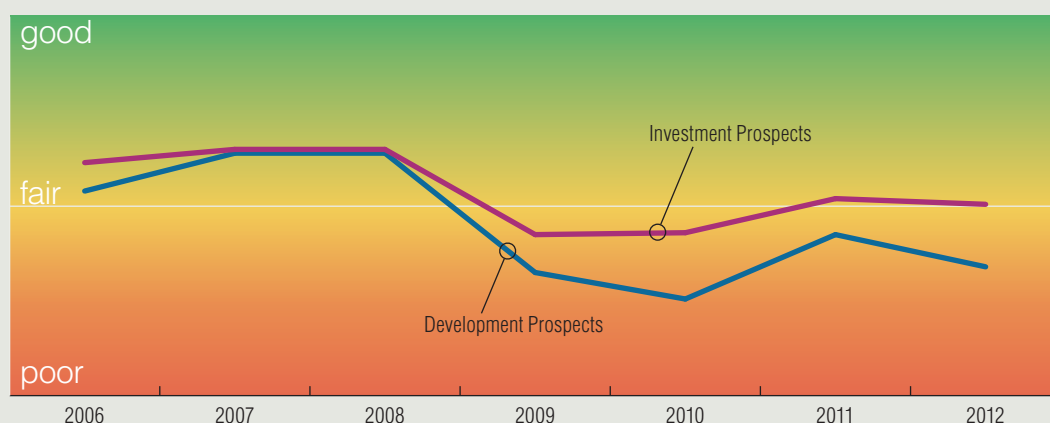
How, when, and where will the European debt crisis end? Only one thing is certain for Europe's economies this year: uncertainty.

In last year's *Emerging Trends* report, investors said they were eschewing a strategic focus on whole countries, cities, or sectors in favour of asset-led, deal-by-deal approaches. Given the economic outlook, that theme will persist throughout 2012. As described in chapter 1, interviewees reported that nowhere can be considered a “must buy” today.

This was reflected in the survey data, too. Although more

EXHIBIT 3-1

## Average City Prospect Ratings



Source: *Emerging Trends in Real Estate Europe 2012* survey.

Note: Investment prospects are the average of prospects for both existing and new investments.

surveys were completed for this year's report than for last, many respondents were reluctant to answer specific questions on cities and asset types, with very few prepared to rate all 27 cities covered. Therefore, response rates on these questions were lower than for other parts of the survey questionnaire.

The telltale sign of agnosticism across the region is that values posted for European cities could hardly be described as electric; over half the cities ranked recorded a lower investment score than last year, including major markets such as London and Frankfurt, as well as Copenhagen, Madrid, and Rome.

Although Istanbul tops the ranking for new investment prospects, its attractiveness to investors is perhaps more symbolic than real—more of a comment on its exciting economic growth prospects than a sign that capital is about to flood to that corner of the continent. As the interviews revealed, 2012 is about staying safe and not straying too far from what you know—especially if that involves a move to both unknown and high-risk markets.

But even amid the collective cheer for “safe havens,” dissent exists. London—the “gold bar of real estate”—has

dropped from near the top ranking in 2011 (second place for new prospects and development and third for existing investments). Now it is just hanging on at the end of the top ten. Interview data suggest this position most likely reflects investors' feelings that the city is overpriced and their anticipation that very little capital appreciation will occur in core assets over the short to medium term as the city battles with a new economic era and all of the painful adjustments it will bring. “Today London is the safest of havens that there is. But once the world is again stable and everyone pulls their money back home, that's when we will see how oversold it is,” said one interviewee.

Given these themes, survey data for 2012 suggest some interesting trends for markets and sectors over the coming months. Here are the highlights:

- Istanbul holds firm in the top spot for new investment and development prospects. It is now also ranked first for existing prospects, rising from second place last year. Turkey-based interviewees were among the most optimistic about business performance this year.
- London suffered declines in all three categories this year, dropping eight places for new property acquisitions, seven places for existing performance, and six places for development.
- Moscow is a new entrant in the top ten for new investments, jumping from 12th place in last year's survey to second this year. It has also climbed from ninth to second place for development prospects. Of Russia-based interviewees, 82 percent foresaw deployment of more capital into real estate in 2012, and 75 percent thought profits would increase this year.
- Respondents believe investment will increase in just one-quarter of the 27 markets surveyed this year—Berlin, Hamburg, Istanbul, London, Moscow, Munich, and Stockholm—although capital values and rents are likely to stay the same for most of them. Cities such as Paris and Frankfurt will experience no increase.

Not surprisingly, in surveys and interviews this year, the new European austerity featured strongly in assessments of how individual property markets would perform, making the countries coming in top and bottom for business optimism this year worth noting.

## The Pessimists

Based on their assessment of business confidence and profitability over the coming months, respondents from France, the Czech Republic, and Portugal showed the least optimism this year.

**France.** With €177.9 billion of funding needs this year, President Nicolas Sarkozy has been laying the groundwork for the loss of France's AAA rating by telling his electorate that a downgrade would not be “insurmountable.” Such rhetoric is little comfort for Europe's second-largest economy, which

EXHIBIT 3-2

### Metropolitan Area Investment Prospects for 2012

		good	fair	poor
		Existing Investments	New Investments	Development
1	Istanbul	3.83	3.82	4.03
2	Munich	3.77	3.60	3.36
3	Warsaw	3.67	3.50	3.40
4	Berlin	3.62	3.50	3.09
5	Stockholm	3.53	3.54	3.22
6	Paris	3.53	3.34	3.13
7	Hamburg	3.50	3.52	3.10
8	Zurich	3.47	3.41	3.50
9	Moscow	3.46	3.69	3.55
10	London	3.40	3.31	3.12
11	Vienna	3.38	3.18	2.90
12	Helsinki	3.22	3.15	2.64
13	Frankfurt	3.18	3.13	2.73
14	Prague	3.10	3.17	2.81
15	Copenhagen	3.02	3.23	2.97
16	Lyon	2.92	2.84	2.49
17	Edinburgh	2.72	2.70	2.38
18	Milan	2.71	2.62	2.20
19	Amsterdam	2.71	2.74	2.30
20	Brussels	2.70	2.74	2.24
21	Madrid	2.52	2.72	2.01
22	Rome	2.49	2.41	2.07
23	Barcelona	2.48	2.66	1.98
24	Budapest	2.29	2.33	1.91
25	Lisbon	2.26	2.33	1.83
26	Dublin	2.26	2.53	1.90
27	Athens	1.52	1.87	1.47

Source: *Emerging Trends in Real Estate Europe 2012* survey.  
Note: On scale of 1 to 5.

EXHIBIT 3-3

### Expectations Regarding Amount Invested, Rents, and Capital Values for 2012

	increase	stay the same	decrease
	Amount Invested	Rents	Capital Values
Istanbul	2.31	2.57	2.45
Munich	2.36	2.51	2.49
Hamburg	2.43	2.62	2.64
Berlin	2.44	2.61	2.66
Moscow	2.46	2.58	2.59
Stockholm	2.49	2.65	2.57
London	2.50	2.74	2.88
Warsaw	2.61	2.62	2.63
Zurich	2.64	2.58	2.56
Copenhagen	2.68	2.88	2.88
Paris	2.71	2.90	2.91
Helsinki	2.75	2.93	3.00
Frankfurt	2.78	2.96	2.99
Vienna	2.92	3.05	3.08
Prague	2.93	2.83	2.90
Dublin	3.03	3.42	3.42
Lyon	3.07	3.11	3.11
Amsterdam	3.10	3.29	3.40
Madrid	3.14	3.45	3.39
Edinburgh	3.26	3.41	3.44
Brussels	3.30	3.24	3.36
Milan	3.33	3.36	3.55
Barcelona	3.34	3.50	3.51
Rome	3.43	3.50	3.61
Budapest	3.46	3.31	3.28
Lisbon	3.56	3.71	3.82
Athens	3.84	4.27	4.22

Source: *Emerging Trends in Real Estate Europe 2012* survey.

Note: On scale of 1 to 5.

in 2011 watched the premium it pays to borrow for ten years increase by 40 basis points over Germany's. To restore faith, the government introduced a €65 billion austerity package in November 2011, with most savings over 2012 coming from tax increases, including a 5 percent increase in corporate tax.

France's property professionals were among the most depressed of *Emerging Trends* respondents about 2012; just 5 percent felt their business confidence would increase over the year, while only 16 percent expected an increase in profitability. About 11 percent believed headcounts would increase during the year.

"The scale and possible implications of the sovereign debt crisis are frightening; will we be able to pay back all of the sovereign debt that has been taken on? Since August, the economy has deteriorated and the availability of debt has shrunk. Our business is prepared for recession, as well as possible exits and dissolution of the euro. We have factored this into our plans," said one France-based interviewee.

Aside from the economy, a top concern was the impact of regulation, with 68 percent of French respondents expect-

ing it to have an increased effect on their business in 2012.

"New rules in France regarding use of tax losses make asset sales difficult. And instability in tax and regulatory regimes makes foreign investors nervous; it is a big problem." "Tax burdens on investors will increase, but this is the way of life today—we have to deal with it. Regulations are becoming increasingly complex—both local fiscal measures and those at a European level."

As in many markets, absence of debt capital was a key factor constraining businesses, and interviewees were concerned about occupier demand, too. "In 2008, corporations reacted quickly to find solutions to their occupier issues, reviewing space requirements and renegotiating tenancy agreements. Now, it's much harder for either investor or tenant to identify savings as costs have been cut and operations have already been rationalised."

Anticipated presidential elections this spring are unlikely to help transactional activity during the first quarter, say interviewees. "If France elects a socialist government, then this could have a great impact on the French real estate industry," said one.

**Czech Republic.** Survey responses and interviews from the Czech Republic made the bleakest reading. No property professionals from this market foresaw an increase in their business confidence, profits, or headcount this year. The statistics could be correlated to pessimism that came through in answers to other questions; a vast majority of Czech respondents believe the sovereign debt crisis will increase in impact this year and that regulation will affect them more in 2012 than in 2011.

Czech respondents were also worried about their economy. Growth is set to slow from an already modest 2.1 percent in 2011 to 1.6 percent in 2012, after contracting in the third quarter for the first time since 2009. Government spending cuts have curbed household spending, but the impact of the debt crisis on demand for the country's exports is also a factor. The Czech Republic's main trading partner, Germany, accounts for 30 percent of total Czech foreign trade turnover with European Union countries, accounting for 75 percent of Czech foreign trade.

"Ultimately we are exposed to the world economic situation. Opinions that the Czech currency is a safe haven are nonsense; we are not going to be separate from what happens," said one Czech-based interviewee. "Business is going to be very difficult," said another. "Leasing will suffer as tenants postpone moves. The valuation business is going to be slow because banks aren't financing. There will be an over-supply of good-quality stock as banks start forcing people to sell even the good-quality stuff. The market will be in complete distress." "There is no debt finance for development at terms that make sense to us and, at the same time, not much appetite from equity investors to start projects. We are unlikely to start any office or residential projects during 2012 as things stand today."

**Portugal.** It is hardly a surprise that just 6 percent of respondents forecast an increase in business confidence in 2012. Portuguese prime minister Pedro Passos Coelho has already said he plans to commit the country to the “most difficult” budget in memory over the year, which includes plans to slash state workers’ salaries while the government cuts spending and raises taxes to meet the terms of a €78 billion aid plan from the European Union and the International Monetary Fund. The European Commission has predicted that the country’s economy will shrink by 3 percent in 2012.

It is a continuation of the depression experienced in the Portuguese real estate market during 2011, when just €75 million of sales were transacted (the lowest number for a decade, according to CBRE). With Coelho’s budget in mind, interviewees do not see much changing quickly, and just 6 percent said they would increase headcount this year. “I have bad expectations for those industries linked to domestic consumption. Those companies with a diversified presence in international markets will do better.”

Almost 90 percent thought they would see a rise in forced sales by lenders, reflecting interviewee concerns that much of the year will be focused on processing the post-boom debt hangover. “The banking business will be weak in 2012, there will be few refinancing operations, and all the activity will be focused on re-funding.”

## The Optimists

According to their assessment of business confidence and profitability over the coming months, the most optimistic countries were Ireland and Turkey.

**Ireland.** Ireland-based survey respondents and interviewees believe that their economy is through the worst. Ireland showed signs of recovering well in 2011, displaying one of the fastest growth rates in the Eurozone for the first half of the year. Bailout terms, which imposed stringent requirements, have been fully delivered on so far, raising hopes that Ireland can work its way out of its current difficulties. Now, that optimism is being felt in the property market, particularly in the office sector.

Progress has been made since last year, say interviewees, and a majority of survey respondents said they expected confidence to increase over the course of 2012, with headcounts expected to grow as well. “Business has been more brisk in the second half of 2011, and expectations are that 2012 will be better.”

Attracting foreign companies to Ireland has been central to the government’s recovery plan, and the government resisted pressure to lift its corporate tax rate above 12.5 percent to pursue that plan. The strategy has paid dividends for the property market with a wave of social media companies establishing a

base there. One agent reported demand for a total of 300,000 square feet (28,000 square meters) of office space from 40 different clients.

Cross-border investors were positive about the country’s prospects, too. “It is a nice growth story with low tax, low labour costs, a lot of FDI [foreign direct investment], and occupiers looking for new facilities.” “Ireland is one basket case I feel positive about; it is one country which has taken its medicine.” Investors are also focusing attention on the likelihood of increased asset sales from the National Asset Management Agency. The bulk of Ireland-based respondents believed forced sales by lenders would increase in 2012.

Despite all of this, Ireland is not out of the woods by any means; its borrowing costs are higher than Italy’s, and the size of national debt and public expenditure are not exactly comfortable. Consumer confidence is low. Growth figures that show a contraction of 1.9 percent in the third quarter also suggest the country may be struggling with the implementation of austerity measures. Thus, Ireland’s fortunes may change during the course of the year, and the significance of improvements in outlook for property businesses should be balanced against these issues, as well as the fact that Dublin is still one of the lowest-ranked cities in the 2012 survey.

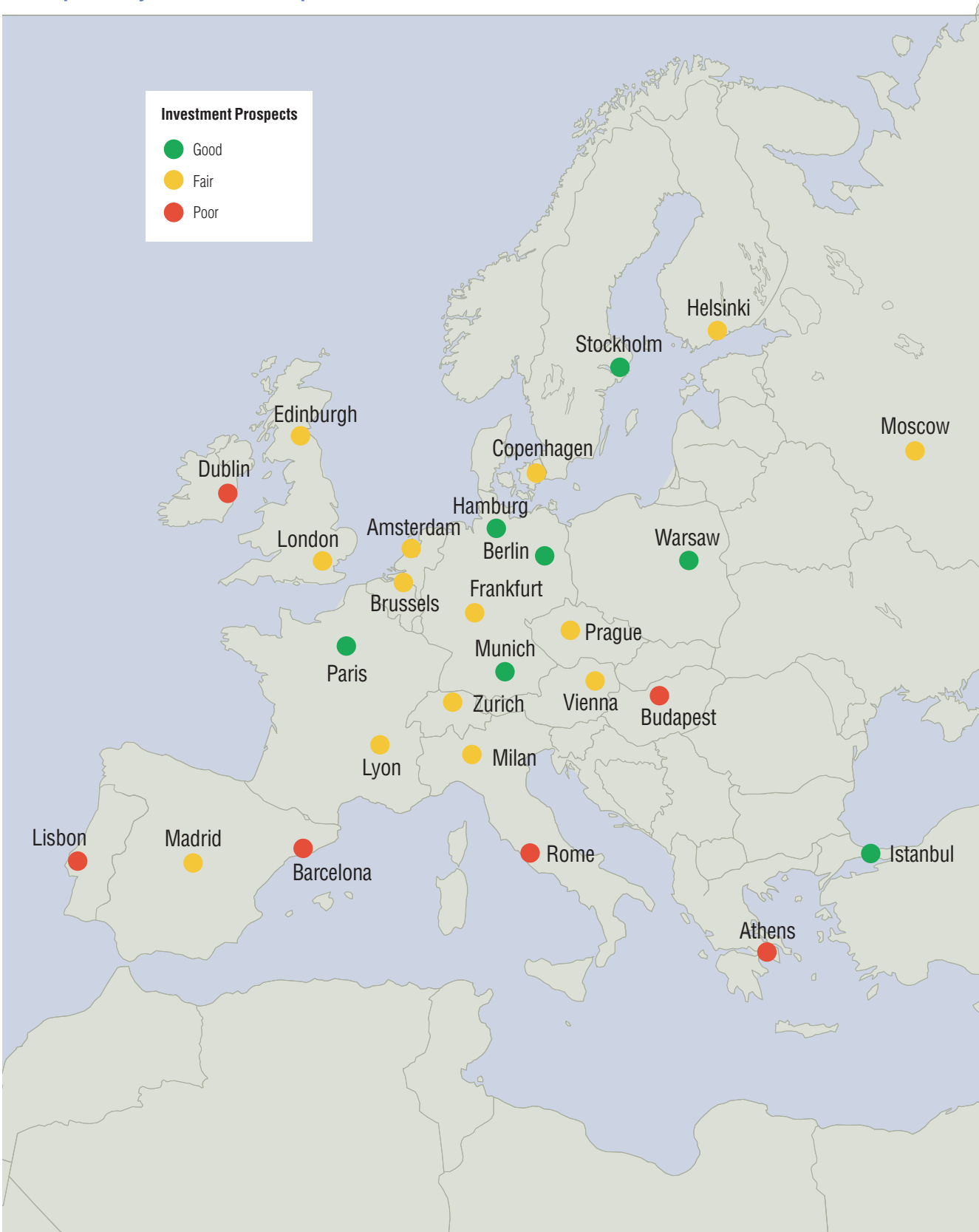
**Turkey.** With economists anticipating growth of 2.7 percent, down from an estimated 7.2 percent in 2011, as recession in the Eurozone and tight monetary policy threaten to result in a sharp slowdown in growth, 2012 may not be a straightforward run for Turkey. But recovery is anticipated by 2013, when it is believed GDP will ratchet back up to 4.2 percent—a long-term growth trend that won votes of *Emerging Trends* interviewees this year. “Turkey is increasingly a country you need to pay attention to; it is the Brazil of Europe,” was how one onlooker described the market.

Turkish survey respondents share the same enthusiasm. They were the most optimistic about growth in headcounts of all respondents, with 69 percent saying they thought their businesses would grow in 2012. Just over half thought profitability would also increase, and 56 percent expected business confidence to rise also.

The market is also positive over a major urban renewal project announced in the wake of last year’s earthquake. The government plans to “rehabilitate” buildings that are at risk of destruction in an earthquake and launch a state-sponsored construction project to build safe and sustainable cities; analysts believe the size of investment could be \$255 billion. “Regulations should not always be considered as preventive. Amendments in the regulations regarding the renewal and reinforcement of current buildings may accelerate the market.”



EXHIBIT 3-4  
European City Investment Prospects



## Top Investment Cities

The top cities in the survey tend to be either in western and northern Europe or in growing regions to the east. The top five investment markets are Istanbul, Munich, Warsaw, Berlin, and Stockholm. The top markets are discussed here from top to bottom.

**Istanbul (1).** For the second consecutive year, the Turkish city ranks first for new investments and first for development. Its growing popularity with *Emerging Trends* respondents since 2010 is largely on account of its glowing economic and demographic credentials, which stand out across the region.

But the country is not immune to Europe's woes: 2012 growth estimates have been revised downwards, as economists take into account recession in the Eurozone, global financial strains, and the likelihood of continued tight monetary policy to deal with inflationary pressures in early 2012. Interviewees did not display concern over these immediate blips, however; for those either already invested or seeking to invest, Turkey's appeal is based on a long-term view of the future.

Retail property investors are particularly positive. Consumer spending rose by 15 percent in Istanbul's prime shopping centres during the third quarter of 2011 and by 10 percent elsewhere in the country, while recent moves by international brands such as Nike and Zara to expand their operations—both in the capital and in second cities—have boosted confidence. That bullishness is reflected by the selection of retail as the best sector for acquisitions in Turkey. Istanbul's hotel sector was also rated among the best in Europe.

Rents are expected to remain stable this year, reflecting the continuation of a flat line across all sectors for two years in the office and industrial sector and three years in the retail sector. But yields—which stand at around 7.75 percent for offices, 8 percent for retail, and 10 percent for industrial—are expected to decrease this year, one of only two cities where respondents thought that would happen. Investment is also expected to increase.

Istanbul jumped to first place for existing investments from second place in 2011, which reflected interview data, where international investors with assets here reported portfolios are performing well. Some say the market was the best on a pan-European basis.

Despite its objective popularity across investment and development categories, the city is a serious focus only for investors seeking higher-risk growth markets within the region and for those with sufficient resources to take the rough with the smooth. "It's an emerging market so it isn't just about great returns; it's tenants walking away, contracts not being contracts—a roller-coaster ride. But we look at our centres today and see footfalls improving, spending is on the up, and it is where international brands want to be."

Those who have not yet invested in Istanbul but expect to in the future showed no sense of urgency about investing. Rather

than rushing capital into the market, respondents said they were merely investigating the possibilities within Turkey, taking time to understand and learn about the market ahead of the pack—again reinforcing its place as a decent long-term story.

"Turkey is removed from the rest of Europe and that is a plus, but it is always a question of risk-adjusted returns and how I achieve that; this is something I am thinking about a lot. There are many good opportunities because it is an underdeveloped and fragmented market, but finding the right investments is by no means easy."

Fund management interviewees also raised the point that even though promising fundamentals make Istanbul an appealing prospect, institutional investors are not generally supportive of strategies that stray from core European markets.

EXHIBIT 3-5  
Istanbul



**Munich (2).** With one of the lowest unemployment rates in Germany, Munich's economy is perceived to have fared well in the recent economic malaise. Therefore, its popularity for both existing and new investments is based on the idea that the city is one of Europe's safe havens: a "deep and liquid market" and "more stable" than Frankfurt. The city is benefitting from investors' need for refuge, and Munich was frequently mentioned alongside cities such as London, Paris, and Stockholm for this reason.

Recent research bears out the view seen in the surveys. Investment sales rose 41 percent in the third quarter, compared with the same quarter in 2010, and international investors accounted for a large share of third-quarter turnover, according to CBRE. A buoyant leasing market, especially driven by media and automobile companies, as well as a low vacancy rate also helped boost confidence for 2012.

EXHIBIT 3-6

## Best Sectors for Acquisitions in 2012, by City

	sector recommended by					respondents
	30 or more	15–29	14 or fewer			
	Office	Retail	Industrial	Apartment	Hotel	Best Sector for Acquisition in the City
Amsterdam	17	19	8	14	10	Retail
Athens	5	12	3	9	17	Hotel
Barcelona	28	33	9	13	12	Retail
Berlin	43	42	7	58	12	Apartment
Brussels	14	16	4	6	2	Retail
Budapest	13	16	9	1	2	Retail
Copenhagen	14	18	3	13	3	Retail
Dublin	14	4	2	7	3	Office
Edinburgh	15	7	2	3	5	Office
Frankfurt	47	30	13	32	3	Office
Hamburg	43	35	18	43	6	Office, Apartment
Helsinki	17	17	5	5	1	Office, Retail
Istanbul	26	34	8	20	20	Retail
Lisbon	13	10	4	7	8	Office
London	74	36	14	51	24	Office
Lyon	20	13	13	5	3	Office
Madrid	37	31	6	15	14	Office
Milan	25	37	6	10	6	Retail
Moscow	16	21	7	8	5	Retail
Munich	62	49	10	44	16	Office
Paris	81	52	11	25	18	Office
Prague	28	22	5	1	4	Office
Rome	14	29	1	9	6	Retail
Stockholm	24	26	7	15	3	Retail
Vienna	14	13	4	17	3	Apartment
Warsaw	42	37	9	8	6	Office
Zurich	12	10	1	6	0	Office

Source: *Emerging Trends in Real Estate Europe 2012* survey.

"It is a refuge market in these times," said one interviewee. The office sector was overwhelmingly favoured and ranked as one of the top three in Europe in the survey, behind London and Paris, a function of positive performance in both the leasing and transaction market in 2011. Take-up in the Bavarian capital was the highest of the five German office markets during the first nine months of the year, and vacancy rates decreased from 8.5 percent to 8.3 percent over the course of 2011.

Residential assets are the third most attractive in Europe, after Berlin and London, another sign of investors' desire for safe, stable cash flow within portfolios. Munich's retail property was the second most attractive in Europe, following from a major investment in a large-scale mall from a major U.S. pension fund last year.

But observers have warned of bubble-like pricing as a result of strong interest for German assets in 2012. "Large equity institutional investors are now increasingly interested in direct investment. The run on quality and refuge cities has made German cities almost bubble-like. We sold an asset at a yield that has exceeded all of our optimistic expectations and at a very large margin. At these prices, we would sell our entire portfolio in Germany."

EXHIBIT 3-7  
Munich

**Warsaw (3).** Warsaw may be third in the city rankings this year, but outsiders have more positive feelings for the market than domestic investors. A firm favourite on international investors' shopping lists—following London, Paris, the main German cities, and then Stockholm—Warsaw's stable economy is its biggest pull factor. In 2011, Poland displaced Russia as the strongest magnet for foreign real estate investment in Europe, according to Real Capital Analytics.

Investors anticipate the city's increasing prominence as the financial centre for the eastern European region, making Warsaw's office sector a prime focus; in *Emerging Trends* surveys, it was the one of the most highly favoured office sectors in Europe.

But retail was more highly rated on a regionwide basis than the office sector. A key destination for international brands, extremely low vacancy rates (below 1 percent in September) and undersupply are pushing rents higher. In surveys Warsaw was ranked highly for retail, ahead of Milan. The inability of developers to find financing means retail is likely to remain a supply-constrained market for some time.

As well as being the star performer in the central and eastern European (CEE) region because of strong domestic demand and robust growth through 2011, Poland was the only European Union country to avoid recession in 2009. "Warsaw is where everybody wants to be right now," said one onlooker. One pan-European fund manager interviewed reported that raising capital for Poland had been successful with investors.

But the sentiment of Poland-based interviewees was more reserved. Concerns exist over how a regionwide slowdown will affect the country. Reflecting broader business surveys and labour market data expectations that the Polish economy will slow by the second quarter of the year, economists downgraded 2012 GDP growth forecasts from 3.2 percent to 2.5 percent in November.

"Warsaw is in great demand because of high labour migration and its favourable demographics. However, there is a low rate of salary increases, and social optimism is not high." One CEE-based investor thought yield compression was over: "Many have rushed into the Warsaw real estate market, which could lead to overheating." "Times are uncertain, and no one knows what will happen. Reality may hit us. All will depend on the discipline in the Eurozone."

Limited bank finance is just as much a concern in this market as anywhere else. Although domestic banks have available funds and debt is available, fear exists that international parents of local banks will begin pulling funds to their home markets over the coming months.

So despite general optimism in survey data, domestic interviewees saw no greater prospects for their city in 2012 than anywhere else. Those with decent projects or new projects with a high degree prelet will be able to refinance whereas others will struggle, speculative purchasers will not find debt unless the property is very well located, and devel-

opers are hanging back while they assess how 2012 will treat the Polish market.

"It is time for careful observation. We do not plan to start high-risk projects." Said another interviewee, "2011 was a very good year for our business, but we are preparing for more difficult times. The first half of 2012 won't be so bad, and bank financing may be still obtained, but we foresee the situation worsening in the second half of the year."

Residential, in particular, is perceived as a high-risk sector by interviewees owing to oversupply, and prices are anticipated to fall over the year. This concern is reflected in survey data, which ranked residential in the city in the bottom half of markets surveyed. "Prices in the residential market will drop by at least 10 percent."

EXHIBIT 3-8  
**Warsaw**



**Berlin (4).** Berlin was one of Europe's most highly rated residential markets for residential investment, according to *Emerging Trends* surveys this year, and ranks fourth for existing property performance overall in Europe. Its appeal, like that of fellow German cities, is stability, and its popularity with interviewees reflects a wider search for safety in today's market. "Even when you are offering shares in a boring Berlin residential company, the investor universe is wide ranging—from hedge funds to long-term investors, with holding periods between three months and ten years. Some are interested in dividends; some are interested in growth."

German residential is a popular choice for investors, but Berlin represents good value for money in comparison to other cities, say interviewees. Investors with residential



portfolios report increases in rents and purchase prices for well-located inner-city areas. Confidence in continued future demand is based on an increasing population in the city, especially in central districts such as Mitte, Friedrichshain-Kreuzberg, Pankow, and Treptow-Köpenick.

Interviewees also rated the office market well, where high demand for office space is believed to exist. It was rated among the five most attractive office markets in surveys. “Berlin is often the first entry point for foreign investors. But it is not only residential; they like offices, too.” “Berlin is very attractive in terms of both office and residential real estate.” Firm occupational demand from service companies such as lawyers, tax advisers, and auditors helped take-up in the first three quarters of 2011 reach its highest volume in ten years, resulting in upwards pressure on prime rents in the city, according to Jones Lang LaSalle research.

The figures reflect the wider business confidence in Germany, which climbed for a second month in December 2011 on predictions that Europe’s largest economy had successfully steered away from recession in 2012. Investors hope that consumer confidence will hold up while a decline in exports to the Eurozone is offset by demand in emerging markets and the United States.

Business confidence within the property sector was more modest; Germany-based *Emerging Trends* interviewees came fourth in rankings for expected improvements in confidence this year, and third for improvements in profits. However, Germans were the most positive about business for 2012 compared to peers in Europe’s core markets. Only respondents in high-growth markets, such as Turkey and Russia, ranked more positively.

**Stockholm (5).** Stockholm was another firm favourite with investors in picking safe European cities. They have been impressed by Sweden’s strong performance through the financial downturn to date, after it emerged as one of the strongest markets in Europe owing to strong public sector finances and a solid export-driven economy. Its economy is expected to grow 4.2 percent in 2011. Swedish banks, which passed 2012 European Union stress tests by wide margins, also appear to still be financing today.

“Stockholm is growing rapidly.” “Stockholm needs to build a massive amount of residential to cover the constant inflow of people.” “Stockholm is one of the most attractive cities in Europe; it has a strong economy, diversified business climate, and low dependency on the financial sector compared to cities like London.”

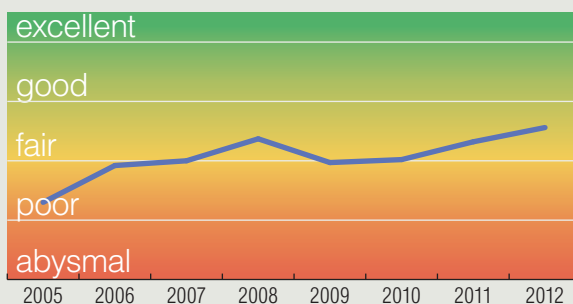
Cross-border investors have been particularly focused on the retail sector, which was reflected in *Emerging Trends* survey data showing the sector is considered Stockholm’s best buy. Healthy growth in retail sales, low vacancy, and limited supply in central locations have created rental growth and yield compression here, and similar conditions in the office market have led to yield compression in the central business district, too—around 4.75 percent (although this market is largely dominated by domestic buyers).

Sweden-based interviewees confirm the perception that banks are still lending (albeit at higher pricing) for new business as well as refinancing, but they were on the whole very cautious about the outlook for 2012. Again, perception on the ground is more modest than that of those who look at the market from afar: “Even if Nordic banks are relatively healthy and in good shape, our local market is too small for them to be able to fund

EXHIBIT 3-9  
Berlin

	Prospects	Rating	Ranking
Existing Property Performance	Good	3.62	4
New Property Acquisitions	Good	3.50	7
Development Prospects	Fair	3.09	10

#### Investment Prospects

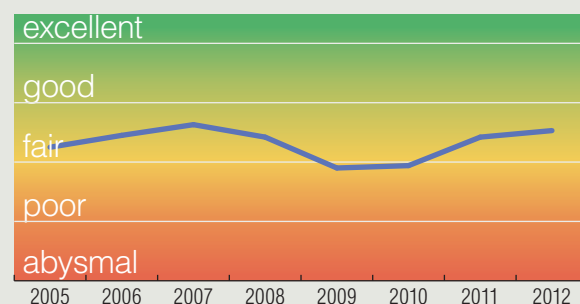


Source: *Emerging Trends in Real Estate Europe 2012 survey.*

EXHIBIT 3-10  
Stockholm

	Prospects	Rating	Ranking
Existing Property Performance	Good	3.53	5
New Property Acquisitions	Good	3.54	4
Development Prospects	Fair	3.22	6

#### Investment Prospects



Source: *Emerging Trends in Real Estate Europe 2012 survey.*

themselves amongst each other, and hence they are impacted by what is happening with their peers internationally.”

Interviewees are concerned that the country has weakening growth prospects for 2012 (latest forecasts have downgraded GDP estimates to 0.6 percent from 1.9 percent) because of continuing issues in the Eurozone and strains on exports. “In the 2008 crisis, the economy quickly rebounded thanks to decreased interest rates and tax incentives that made consumption grow rapidly. This time, however, tax incentives are not planned.”

Interviewees believe transactions will stay subdued during 2012 but are positive about Sweden’s long-term prospects, saying its relatively strong economic fundamentals will set it in good stead once investors come to increase allocations to real estate once again.

Along with the United Kingdom, Germany, and France, it is considered as one of the solid, core “northern European” markets. “My international shopping list is London first by a million miles, then Paris, then German cities in no particular order of preference. Then Stockholm and Warsaw. After that, you start to struggle.” “You can’t not have a Nordic investment as a European property investor,” said another.

**Paris (6).** Paris is the sixth-most-favoured market overall, and its retail, office, and hotel sectors are highly rated by investors looking for acquisitions.

This is somewhat at odds with interviews, where most investors reported that Paris offered the best opportunities in 2012, along with London. “The market has scale, liquidity, a reasonably protected legal framework, and a diverse range of tenants.”

Although it was frequently ranked with London as the region’s top market, Paris was considered as more attractive by some because it is less dependent on the financial sector. “When I compare London to Paris, the first thing is that London is stretched and the market is more volatile. Real estate cycles are more pronounced in the U.K. capital.”

Away from the main sectors, investors suggest converting older office buildings into residential was one opportunity, and hotels was a promising sector. “Paris’s luxury hotel segment has doubled in capacity during the last eight years; this additional supply has been well absorbed, and I think that demand from tourism in the future will grow at a faster pace than supply.”

The market is so highly regarded that interviewees are reporting seeing yield compression in recent months. “Real estate is like gold; it allows investors to protect their invested capital. I have seen several private wealthy families investing in core-plus property in the city at yields below 4 percent.” But this situation may be the source of negative sentiment; the focus is on core property, and the supply is limited—which is why Paris ranked ninth for new investment opportunities.

Some interviewees thought that Paris, like London, had “passed the peak,” with predictions of a potential rental decline in the central business district office market as

strains on occupier markets emerge. DTZ Research recently estimated that Paris’s central business district was 12 percent overvalued. Investors are also concerned about the prevalence of short-term leases giving tenants the right to terminate every three years if the occupational market begins to feel stress in 2012.

So although Paris has safe and attractive credentials relative to other markets, it has become a victim of its own success this year. “The difficulty with Paris and London is that is where everyone else wants to invest. So investments are very difficult to make, and that teaches you to look elsewhere.”

EXHIBIT 3-11  
**Paris**



**Hamburg (7) and Frankfurt (13).** Dependable rather than exciting, Hamburg and Frankfurt will continue to benefit from interest in stable economic markets this year and are listed interchangeably with other top markets Paris and London.

“I like German cities in no particular order.” “Frankfurt, Hamburg, and Munich are good for all asset types now and in 2012.” “Frankfurt, Munich, and Berlin are always interesting.” Interest in German assets is such that transaction volumes in Hamburg for the first three quarters of 2011 were 55 percent higher than for the same period in 2010.

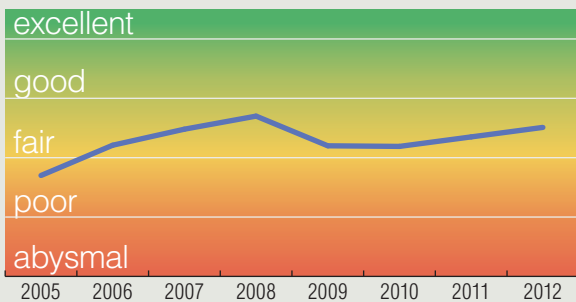
Surveys rated both Hamburg and Frankfurt in the top five for residential and office assets. Hamburg also ranked top for industrial investments, following healthy investment activity in the warehouse and logistics sector in the wider Hamburg area, while Frankfurt was third.

Even though demand in Hamburg’s office sector is led by the public sector, it has a diverse occupier base that includes

EXHIBIT 3-12

**Hamburg**

	Prospects	Rating	Ranking
Existing Property Performance	Good	3.50	7
New Property Acquisitions	Good	3.52	5
Development Prospects	Fair	3.10	9

**Investment Prospects**

Source: Emerging Trends in Real Estate Europe 2012 survey.

publishing, media, and advertising companies as well as service firms. Investors think this diversity provides a cushion for any adverse impact from a 2012 economic downturn. Investors in the best locations in the city also report office rental growth of around 2.2 percent for new-build space.

Promising population growth between now and 2025 makes residential assets an attractive bet, too. Hamburg also rated highly for retail, and Hamburg-based interviewees mentioned that the sector was interesting because of strong transactions during 2011.

Despite being high up on lists for most-favoured cities in the interviews and its residential and office sectors being highly regarded, Frankfurt's position in the city rankings has fallen this year across all categories. It is now only the 13th-best market for existing investments (down from eighth last year), 15th-best market for new acquisitions (down from ninth), and 14th for development (down from 13th). Its dependence on the financial sector and a vacancy rate of 17.3 percent in the office market are negatives.

But as with so many market choices this year, Germany's relatively strong economic position makes it top in people's minds, even though market specifics are not perfect.

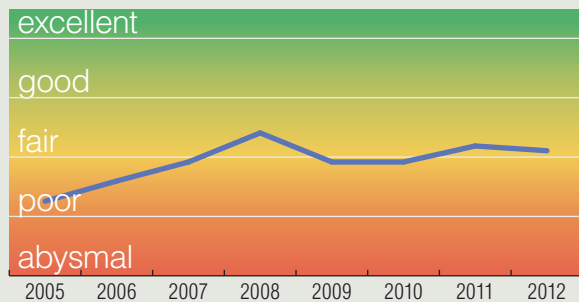
**Zurich (8).** Zurich's place in the top ten is owed to the perception that Switzerland is an economically stable market. A strong base of domestic buyers, such as pension funds and family offices, also keeps the market for Swiss real estate investments buoyant and created a high degree of competition for core assets in core locations.

When Zurich's sectors are ranked against other opportunities in Europe, however, it does not fare well. It ranks second from last among surveyed markets for offices, last for hotel

EXHIBIT 3-13

**Frankfurt**

	Prospects	Rating	Ranking
Existing Property Performance	Fair	3.18	13
New Property Acquisitions	Fair	3.13	15
Development Prospects	Fair	2.73	14

**Investment Prospects**

Source: Emerging Trends in Real Estate Europe 2012 survey.

investment, and better only than Dublin and Edinburgh for retail. Its residential sector is most attractive, but that is still near the bottom in the overall city rankings.

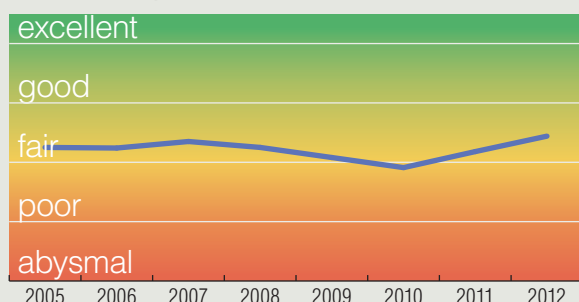
"We're not investing in Switzerland or Austria as we don't see value there, and the markets are not transparent. Switzerland has enough capital to sustain itself, and the yields are too low there to offer any opportunities."

Switzerland's economy is also expected to suffer in 2012, say Switzerland-based interviewees. GDP growth is expected

EXHIBIT 3-14

**Zurich**

	Prospects	Rating	Ranking
Existing Property Performance	Fair	3.47	8
New Property Acquisitions	Fair	3.41	8
Development Prospects	Good	3.50	3

**Investment Prospects**

Source: Emerging Trends in Real Estate Europe 2012 survey.

to expand by only 0.2 percent in 2012 as currency appreciation and a slowdown in global demand affect exports.

**Moscow (9).** “The phrase ‘emerging economies’ is colonial and outdated. How about we talk about expanding economies and declining economies instead?”

Russia’s economy can certainly be described as expanding. Russia is expected to grow by 5 percent in 2012, the only country that will post faster growth in comparison with 2011. Economists forecast government spending during the first quarter of the year ahead of March elections and an upturn in private investment afterwards, once political uncertainty has abated. Corporate investment is increasing again after a drop-off in late 2010, and the consumer is doing well, thanks to rising salaries and increasing employment. Russia is healthy, not just in the context of Europe, but also globally, where its growth rate beats that of Brazil, a BRIC (Brazil, Russia, India, and China) peer.

Moscow was the fastest climber in the city rankings this year. It has moved up in all three categories: from ninth to second place for development, from 12th place to second place for new investment prospects, and from 12th to ninth for existing investments. Russia-based professionals also scored themselves highly in surveys of business confidence and profitability; 82 percent said they expected to increase capital deployed in real estate this year, 75 percent said profits would rise (making them the top among countries for outlook on profits), and 50 percent said they planned to grow headcounts. Moscow did not do as well in sector rankings, however.

On the ground in the Russian capital, confidence is buoyant. Domestic investors were among the most positive of *Emerging Trends* interviewees. One business reported that it was “very positive about 2012,” adding: “The group holds a lot of cash, cash flow is positive, and we are paying dividends. Demand is twice higher than supply. We are expanding operations; buying new projects and new land.” Another said it had seen a “major shift” in interest from opportunistic investors to value added and believed core-plus investors would come in 2012 and 2013. Said another, “Sovereign wealth funds are increasing their presence, and major private equity groups are looking at Russia, too.”

Interviewees reported availability of financing from Russian banks—though inactivity from European banks—but they note “pricing has become more expensive and construction financing is off the table for international investors.”

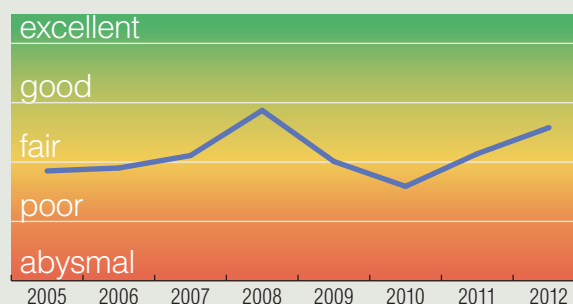
Research forecasts support the confidence displayed during interviews. DTZ Research predicts Moscow will be the best-performing office market between 2012 and 2016, when it expects “sustained yield compression.”

Negatives for Russia-based interviews were the crack-down on construction permits for development in the city and infrastructure problems. As in all expanding economies, however, the best business prospects are over a five- to ten-year period.

EXHIBIT 3-15  
**Moscow**

	Prospects	Rating	Ranking
Existing Property Performance	Fair	3.46	9
New Property Acquisitions	Good	3.69	2
Development Prospects	Good	3.55	2

#### Investment Prospects



Source: *Emerging Trends in Real Estate Europe 2012* survey.

“I plan to accelerate investment into places like Russia in 2012. Western Europe is worrying. The potential unwinding of the euro is a real concern.” “Russia was historically perceived as the outlier. My sense is that this is about to change,” said one Moscow-based interviewee.

**London (10).** “I like London, but I don’t see a lot I like.” This statement perhaps best explains the reason why the U.K. capital is only tenth in the city rankings, having fallen seven places for existing investment prospects, eight places for new investment prospects, and six places for development. Interviewees complain about the difficulty of getting hold of assets, strong competition, and bubble-like pricing. “London is a one-way bet; you are buying in competition with lots of people. It is very hard to be skilful.” “London is too expensive for the economic outlook.”

In truth, the London outlook is rather more balanced, which is reflected in the positive outlook for specific sectors in the city. Undoubtedly, however, the city faces headwinds, and interviewees report occupier demand has been pushed back while businesses hold off from committing to new space, renewing their existing leases for the short term.

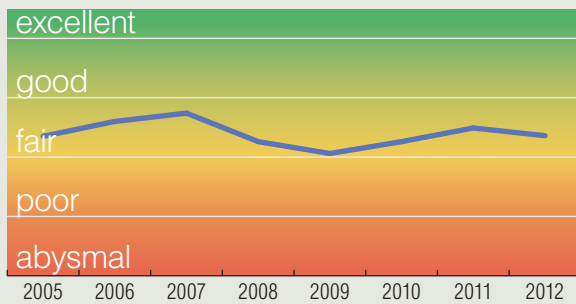
Interviewees are also concerned that the U.K. capital, like Paris, has reached its peak. But there are positives: the city’s population is growing, it is a liquid market, and despite economic strain, it is considered a safe haven by cash-rich institutions, sovereign wealth funds, or private wealth investors that will buy across all sectors and lot sizes—from large offices to luxury residential—in the capital before they go elsewhere in Europe.

“Do I think prices on Bond Street are very expensive? Yes, of course. But will there be an unloved building in London



EXHIBIT 3-16  
London

	Prospects	Rating	Ranking
Existing Property Performance	Fair	3.40	10
New Property Acquisitions	Fair	3.31	10
Development Prospects	Fair	3.12	8

**Investment Prospects**Source: *Emerging Trends in Real Estate Europe 2012 survey*.

that's interesting? Absolutely. Do I feel better about property in London or Istanbul in the long run? London."

London-based investors believe prospects for the West End are better than for the City this year, as the district dines out on recent moves from media and technology companies into the area, and yield compression is still being forecast here. "It is tough to buy here, but the prospects seem pretty good. Retail in the West End is spectacular; rental growth on Regent Street and on Bond Street is now spilling into nearby areas." Although long-term growth prospects for the City market look good, interviewees are more bearish on the City, where immediate occupational requirements and rents could come under strain if depression in the financial sector persists throughout 2012. (Short-term rental forecasts for this district have been downgraded by DTZ recently, along with that of Paris's central business district.)

In addition to a second-place ranking for offices, the residential and industrial sectors also each took second place in the Europe-wide sector rankings. London hotels are considered the most attractive in Europe due to the strength of tourism, which is holding up well in the current downturn. But investors also like the hotel sector because it is an asset class where competition from institutions and pension funds is low.

Though some are now wary of the overheating high-end residential sector, it was a sector cited frequently by those looking at London, from affordable family rental property to luxury assets in prime residential locations such as Chelsea. "There is also opportunity to provide rental properties aimed at older people who no longer want to have all of their capital tied up," said one.

## Less-Favoured Markets in Western, Northern, and Central Europe

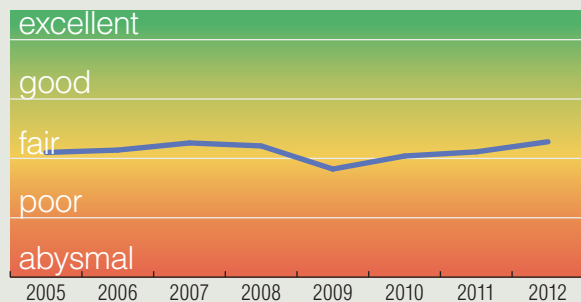
Investors were less positive about a number of cities in western, northern, and central Europe, including Vienna, Helsinki, Copenhagen, Prague, Lyon, Edinburgh, Amsterdam, Brussels, Budapest, and Dublin.

**Vienna (11).** Vienna has moved slightly higher in the city rankings this year, but it did not excite much enthusiasm in the surveys or interviews; survey responses suggest that only the apartment sector offers attractive acquisition opportunities. That sector, which was highly rated for acquisitions, has recently seen interest from private investors seeking safe havens for capital.

Although a stable, "unspectacular" market, it is not a major attraction for foreign investors due to a lack of suitable product. It is also considered not very transparent. Vienna-based interviewees were hardly ebullient about their own markets either: "Vienna stays Vienna—boring, but stable." "The Viennese real estate market is very stable, but there are no profit drivers. Secondary office locations in the city are facing loss of demand."

EXHIBIT 3-17  
Vienna

	Prospects	Rating	Ranking
Existing Property Performance	Fair	3.38	11
New Property Acquisitions	Fair	3.18	12
Development Prospects	Fair	2.90	12

**Investment Prospects**Source: *Emerging Trends in Real Estate Europe 2012 survey*.

**The Nordics: Helsinki (12) and Copenhagen (15).** Poor economic prospects for Finland and Denmark have undermined the outlook for these cities in the *Emerging Trends* rankings, at least in the short term.

Finland's Finance Ministry said in December that the country could have entered recession already. Dependent on exports of goods and services—which contribute around 38 percent to the country's GDP—Finland is unlikely to escape

EXHIBIT 3-18  
Helsinki

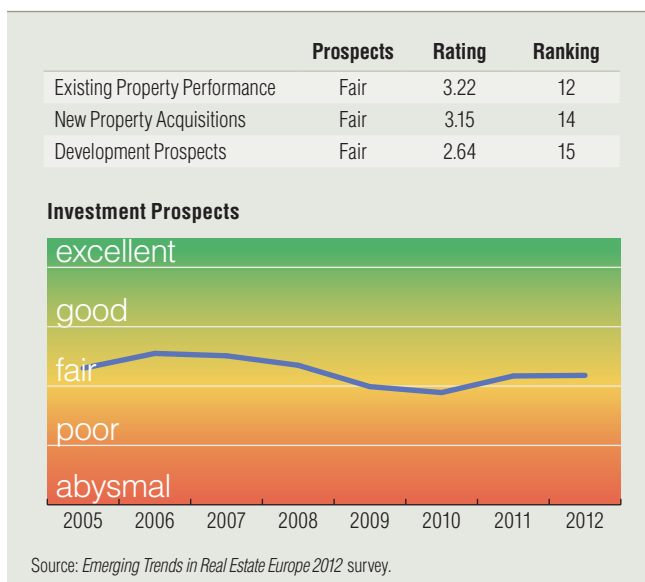
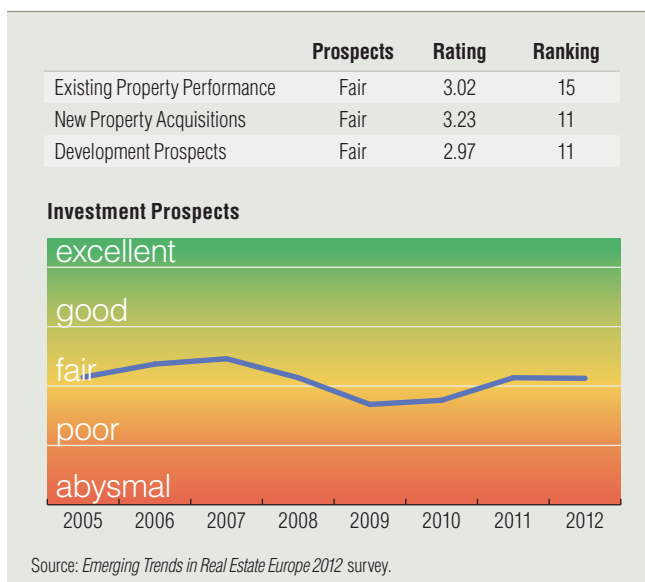


EXHIBIT 3-19  
Copenhagen



the impact of the sovereign debt crisis. To tame its finances, Finland's central bank has warned that substantial spending cuts and tax increases are necessary.

As in many cities, Helsinki office occupiers are focused on well-located modern space in the city centre, but vacancy rates are high at around 12 percent. "Helsinki is suffering from the Nokia syndrome," said one. Conversely, the retail sector suffers from lack of supply, but consumer confidence is wavering in light of the negative economic outlook.

Denmark's property market is relatively small and considered by interviewees as "not very transparent." "To be able to get good deals, you have to know who is selling." Nordic-based interviewees report slow transaction activity, with few distressed properties coming from the banks: "We have been ready to buy since 2008. But there has not been much to buy."

Denmark is currently Scandinavia's worst-performing economy and is grappling with falling consumer spending, exacerbated by a six-year low in housing prices. Danish banks are likely to continue to find life difficult in 2012. With banks already facing pressure to refinance government-guaranteed debt in 2011, interviewees expressed concern that exposure to poor-quality commercial property assets will drag further on banks' books, leading to increased losses on loans and depressed profits.

But there is some hope. Rather than austerity, Denmark's new centre-left government has announced plans to spend its way out of economic trouble, which includes an upgrade of roads and railways.

**Prague (14).** In last year's *Emerging Trends*, respondents commented that the Czech Republic might not be as immune to financial crisis as it thinks it is. Those statements now appear prophetic.

"Everything we thought might happen is now coming to pass. Austrian banks have been told to stop lending to central and eastern Europe. Last year's good news seems a long way away. The crisis is back with a vengeance." As in many cities, leasing is expected to be sluggish as tenants postpone moves, and investment transactions will be difficult to finance, or at the very least more costly. "Those with equity can still buy. Some German funds are still active in the region, mostly buying only with equity. There is private equity cash. But they'll

EXHIBIT 3-20  
Prague



have so much choice that they will price accordingly. What's more, they will be able to go wherever they want."

However, respondents do think that although the situation may be "difficult, it is not hopeless." They express some optimism that the Czech Republic will benefit from the growing divide between the north and south of Europe, falling into the safer north camp. Optimism also exists that Prague will benefit from an increased focus on this area of Europe long term, owing to the success of Warsaw.

Interviewees also mentioned the increasing prominence of wealthy local families and entrepreneurs in the market. "Successful local players have brought real estate to the front of people's minds. Czech companies and families are becoming serious property investors. Fifteen years of profits from different businesses represents a lot of firepower. This money is real and will continue to grow. Moreover, they have relationships with local banks and can raise financing."

### Regional Cities: Lyon (16) and Edinburgh (17).

While they are well down the list, both Lyon and Edinburgh have done better in the rankings this year for both new investment prospects and development prospects (although their overall scores were lower relative to last year, as shown in exhibits). While Edinburgh did better for existing investment prospects, Lyon dropped one place.

Although conditions in regional cities are still tough, this mild boost has been brought about because some investors are beginning to search for value growth and opportunities outside of London and Paris, where competition is strong and prices are high. Investment activity in Edinburgh in recent months has attracted bids from pan-European investment managers and U.K. real estate investment trusts. But lingering fear over how austerity measures, public sector cuts, and economic weakness will increase the divide between prosperity in capital cities and the regions means that, for now, investors are still focused on the best assets or the best-located assets in city centres.

"Something well located and multi-let would be attractive in cities where there is restricted supply. We like Glasgow and Edinburgh as they are holding up quite well." "In France, it is about Paris, Lyon, and Marseille. Everything located outside of these big cities will struggle to perform well." "I would invest in Marseille, Bordeaux, and Lyon, but only if I can do the right project." "It is about buying income with opportunities to retain existing tenants and improve the building." "I am open to investing in smaller cities as long as the fundamentals are correct." "If you go to regional markets, don't compromise on building quality. It has to be centrally located with good transport links. And look for tenant commitment."

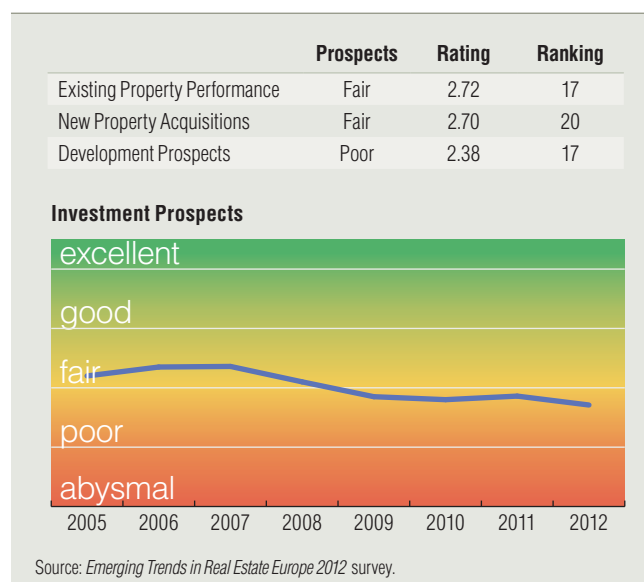
Interviewees expected no rental growth in Edinburgh this year, although it fell in 2010, and landlords have reported rent-free incentives increased to three years on a ten-year lease. Lyon has a diverse occupier base and is home to international headquarters for occupiers such as Interpol. Latest research reported a slowdown in leasing activity during the third

quarter of 2011 and flat rental growth, although no increase in incentives, which remain at six months for a six- to nine-year lease, according to Jones Lang LaSalle.

EXHIBIT 3-21  
Lyon



EXHIBIT 3-22  
Edinburgh



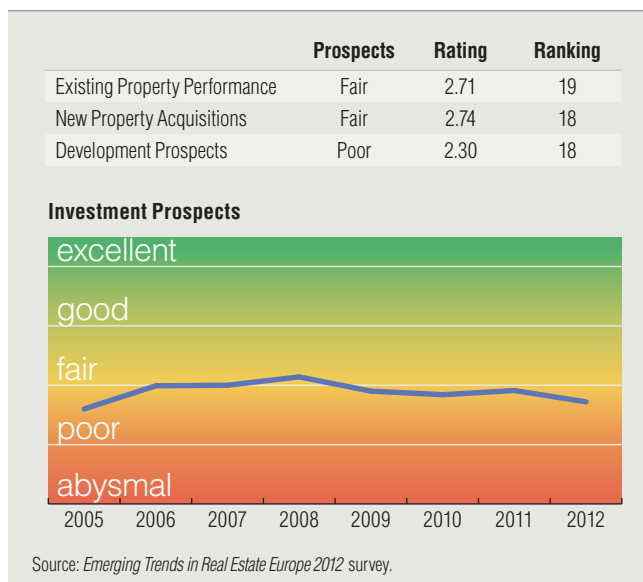
**Amsterdam (19) and Brussels (20).** Both cities scored lower in the city rankings this year and remain towards the bottom end of the European cities league table for two years running. One interviewee summarised the prospects of both thus: "Amsterdam [and Rotterdam] are both catastrophic

due to overproduction and an absence of dynamism. Brussels is catastrophic due to its overregulation, exposure to the European Union, and its old buildings.”

“In the Netherlands we expect a decrease of new capital, possible stabilization, but no increase. There will be no significant growth, but focus on stabilization of markets instead.”

While retail was considered the most attractive sector in Amsterdam, in the Europe-wide sector rankings Amsterdam hotels also were rated quite highly; interviewees placed Amsterdam among the top ten hotel acquisition markets in

EXHIBIT 3-23  
**Amsterdam**



Europe, buoyed by recent investments from a German open-ended fund and a U.S. private equity group. But interviewees did not feel many could take part in the opportunity as they need specific skill sets and cash flows are unpredictable. Large supply in the office market makes this sector unappealing also, although vacancy in the South Axis business district has decreased from 19 percent to 11 percent over the last two years.

In Brussels, interviewees believe opportunity could exist to upgrade old office buildings or convert them into residential. “Brussels does not have very positive prospects due to reduced public spending and rationalisation in both state and international institutions, which amounts to less square meters per civil servant. Redevelopment prospects are better.”

**Budapest (24).** Interviewees made very few comments about Budapest, and the comments that were made strongly suggested it is a “sell” market.

“Everyone wants to get rid of their Budapest investments, which might lead to interesting opportunities.” “The real estate environment in Hungary and the southeastern European region is very difficult and critical.” “Hungary is a disaster. It is politically unstable; an absolute no go. We would leave if we could.”

Positive sentiment is dwindling because of weakness in the economy and the danger of default. Hungary is not forecast to grow at all in 2012 and may experience a technical recession over the first part of the year. Domestic demand is still depressed, and trade is likely to falter as core Europe slows. Interest rates in the near term are likely to rise to defend the currency and react to a worse inflation outlook.

But developments on the political front are equally worrying. New prime minister Viktor Orbán’s democratic credentials

EXHIBIT 3-24  
**Brussels**

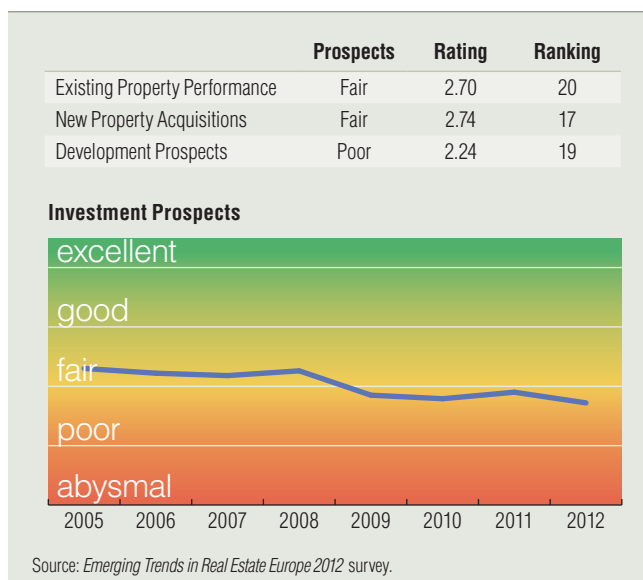
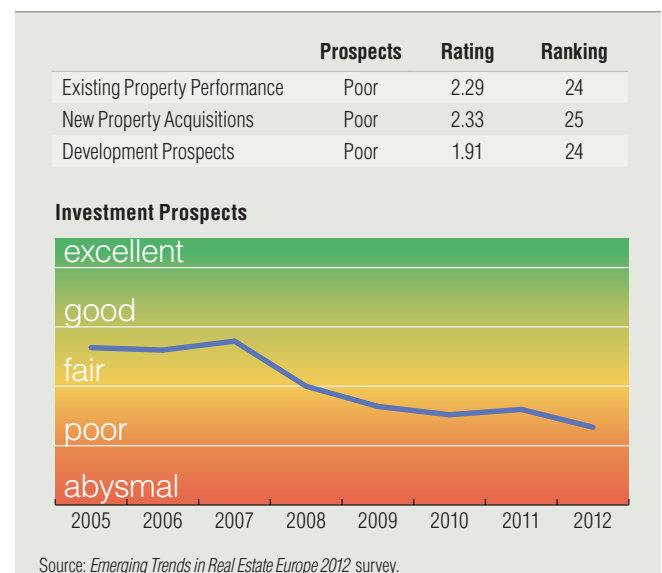


EXHIBIT 3-25  
**Budapest**





have been called into question by critics after moves to eliminate checks and balances on the government, a policy that includes curbing the powers of its central bank and its courts and centralising the media. A new constitution, penned by Orbán's supporters and party officials, was brought into force on 1 January 2012 and met with protests in the Hungarian capital. Orbán has insisted that new laws are needed to bring stability to the country. But the European Union has asked for some to be scrapped as a condition of continuing talks with Hungary over the extension of a new line of credit.

"Hungary could have been interesting, but it shot itself in the foot," said one interviewee.

**Dublin (26).** "If I had a tonne of personal money, I'd invest in Irish property; values have fallen by 60 percent and no one is going to abolish Ireland, but our investors wouldn't let me do it."

Although it ranks second from the bottom on prospects for existing investments, fifth from last for new investments, and third from bottom for development, sentiment for Dublin has greatly improved since last year's *Emerging Trends*, both with outsiders and the Ireland-based interviewees, for reasons explored more fully earlier in this chapter. "Ireland is one country that has taken its medicine. It is one of the basket cases I am more positive about."

Increased activity by Ireland's National Asset Management Agency has drawn interest from investors in Dublin-based schemes recently, while the Irish Central Bank and U.S. bank BNY Mellon have been on the lookout for 200,000 square feet (18,600 square meters) of space in the city, which has helped boost confidence in the city's prospects for 2012.

"We are working with people in Ireland right now. It has a little nice growth story going with low tax, low cost of labour, a lot of foreign direct investment, and occupiers like Facebook

and Google are out looking for new facilities. Some are looking for a new type of building."

"Ireland has come through a very difficult period but there are signs it is going to make it."

## The Southern League

Given the sovereign debt problems throughout the southern region, cities in southern Europe not surprisingly garnered little favour with investors.

**Milan (18) and Rome (22).** Because of Italy's status as one of the main protagonists in the latest European crisis, its two main markets not surprisingly have slipped in rankings this year. Both Milan and Rome scored lower overall in the city rankings and below average for both investment and development prospects.

The newly appointed government—led by Prime Minister Mario Monti—had already been installed as interviews were underway, but little indicated the new administration would make any change to the outlook for property markets in 2012. In the short term, belt-tightening and economic contraction are likely. "The impact of the new Italian government will be positive, but the change will not be sudden. For the first half of 2012, we will still experience variation in the sentiments of the operators and crisis in the spending," said one interviewee. "We are in a black hole rather than at the end of the tunnel where you can see the light," said another.

International investors have long been wary of Italy's bureaucracy, regulation, and lack of transparency, but pricing issues and the economic outlook have heightened negative sentiment this year.

Interviewees believe Italy is not competitive in the current environment, with no relation between the risk involved in investing and the reward. "There are very few real upside opportunities," said one. "No one is interested in Italy at all," said one broker. "How can you explain to your investment committee that Italy and Spain provide interesting opportunities when the bond rate tells a different story?" "Retail is potentially interesting to investors, but at current yields, investors would hardly put their money there, with an average IRR of 6 percent when Italian bonds are somewhere around 7 and 8 percent. The only investors prepared to allocate to real estate under these conditions are pension funds, who have more long-term horizons."

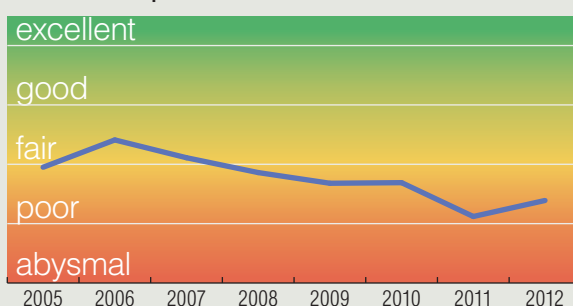
In the sector rankings, Milan was rated highly for retail on a nationwide basis, and retail was also the best sector within the city. The most popular sector in Rome was also retail. These results reflect market data that show 35 percent of the €1.3 billion invested in Italy during the third quarter of 2011 was in the retail sector.

But in the interviews, those who did express interest in buying in Italy said they were most hopeful over the potential sale of state-owned properties, a plan mooted in September

EXHIBIT 3-26  
Dublin

	Prospects	Rating	Ranking
Existing Property Performance	Poor	2.26	26
New Property Acquisitions	Fair	2.53	23
Development Prospects	Poor	1.90	25

### Investment Prospects



Source: *Emerging Trends in Real Estate Europe 2012 survey.*

EXHIBIT 3-27  
**Milan**

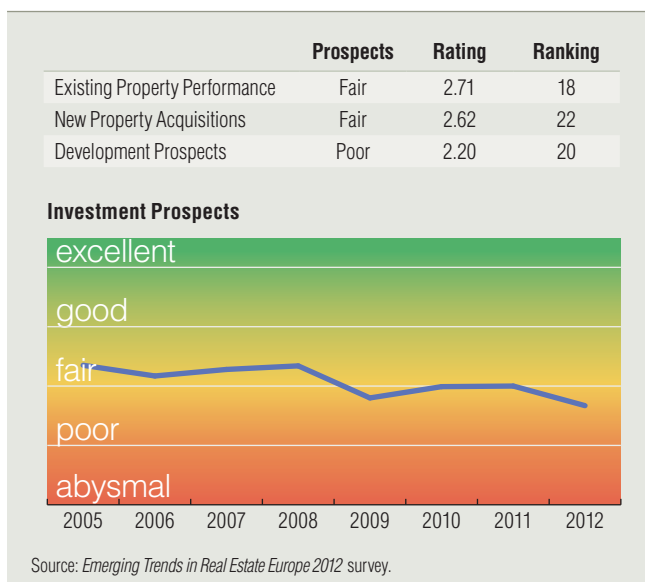
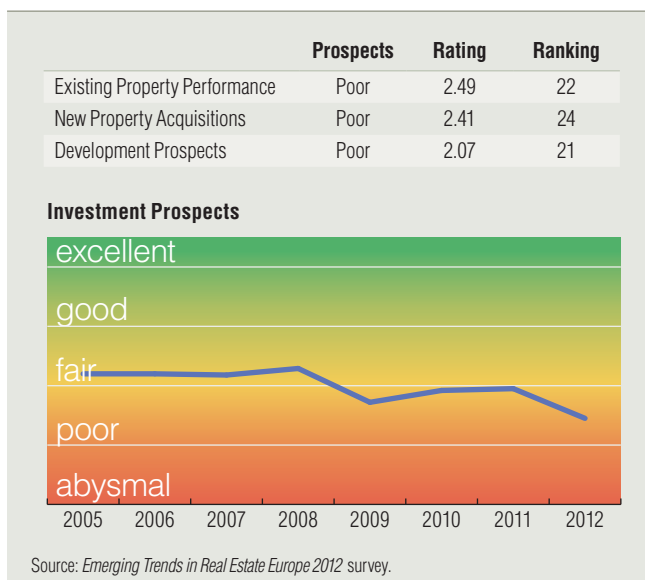


EXHIBIT 3-28  
**Rome**



2011 that hinted the government could raise up to €30 billion from real estate to help reduce its debts. One interviewee described it as a “great potential opportunity, but we hope that this will not be wasted with bad planning.”

DTZ Research suggests offices and retail in Milan are overvalued by 20 percent and 10 percent, respectively, while the latest data show vacancy in the office market has risen to 9.9 percent in Milan.

Rome, which depends on public sector occupiers, is expected to suffer an increase in vacancy rates partly as a

result of the announced rationalisation of office space by the province of Rome. Transactions in the market show an interest in buying empty or almost-vacant offices and turning the assets into residential, retail, or hotels.

**Madrid (21) and Barcelona (23).** In last year's *Emerging Trends*, the outlook for Madrid and Barcelona was cautiously hopeful that Spain had passed the worst of its troubles.

Given the fragile economic situation and the expectation that more austerity measures will be necessary in 2012, Spain's key property markets look unlikely to raise themselves from the lower section of the rankings anytime soon. “2012 is going to be even worse in Spain than 2011,” said one interviewee. “All of our strategy and focus continues to be defensive,” said another.

Spain-based respondents note a “clear and serious demand contraction” since summer 2011 and expect that limited debt supplies will be “strangled” this year, as they foresee foreign banks retreat home and domestic banks focus on soothing their troubles. Of respondents from Spain, 59 percent predicted that the sovereign debt crisis would have an increased impact on their businesses this year, while 70 percent expected forced sales by lenders to increase. “It is better not to do anything anywhere in Spain in the short term,” said one.

Fund managers report equity investors as having only small allocations for Spain, with preference for refuge markets such as London and Paris. Others say prices are still too high to attract investment in both Madrid and Barcelona. “There is always equity available. But the problem is that assets are not available because there has not been a real mark-to-market by the owners, or because the banks are not willing to take losses.” “Losses have to be taken quickly. The new government must introduce hard measures in order to regain international confidence.”

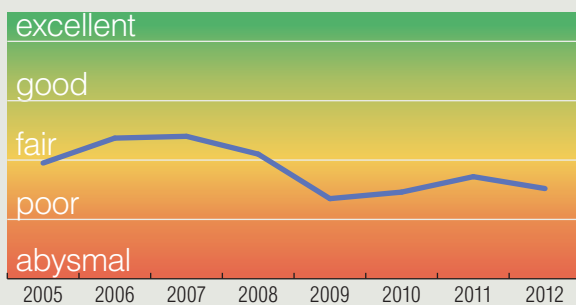
Investors ranked Madrid's prospects more highly than Barcelona's, although they have concerns over the office vacancy rates (10.6 percent) and occupier demand. Investors are focused on well-located prime central business district assets within the inner-city ring road, the M-30, and in well-established business parks. “I am worried about the [downward] trend in rents and [upward] vacancy rates in Madrid. I hope that 2012 is the floor.” Within the city, offices were considered the most attractive sector, but Madrid's hotel sector was rated among the best in Europe on the strength of the city's tourist market. Retail did not register many comments: “Shopping centres? There are already enough.”

Office vacancy was a concern in Barcelona, where it stands at around 13.4 percent, and a downward trend in rents is expected to continue for the best part of 2012. “Barcelona's economic situation is worse than Madrid's and has much more vacant office space.” “Barcelona is losing importance in the European real estate market. The local government of Catalonia inspires even less confidence than the national one.”

EXHIBIT 3-29  
Madrid

	Prospects	Rating	Ranking
Existing Property Performance	Fair	2.52	21
New Property Acquisitions	Fair	2.72	19
Development Prospects	Poor	2.01	22

## Investment Prospects

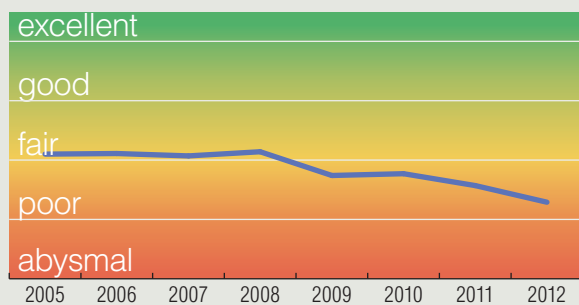


Source: Emerging Trends in Real Estate Europe 2012 survey.

EXHIBIT 3-31  
Lisbon

	Prospects	Rating	Ranking
Existing Property Performance	Poor	2.26	25
New Property Acquisitions	Poor	2.33	26
Development Prospects	Poor	1.83	26

## Investment Prospects

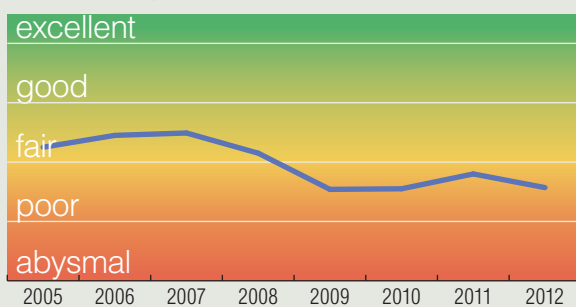


Source: Emerging Trends in Real Estate Europe 2012 survey.

EXHIBIT 3-30  
Barcelona

	Prospects	Rating	Ranking
Existing Property Performance	Poor	2.48	23
New Property Acquisitions	Fair	2.66	21
Development Prospects	Poor	1.98	23

## Investment Prospects



Source: Emerging Trends in Real Estate Europe 2012 survey.

At year-end, Catalonia announced it would tap citizens for up to three-quarters of its estimated €10 billion of financing needs. It has also said it will cut the salaries of 200,000 public sector workers by 5 percent in 2012.

**Lisbon (25).** “Lisbon has a bad hangover, and it will be a long time before anything happens,” said one interviewee, perhaps summing up the general sentiment for Portugal’s capital this year. “Lisbon has always had bad health, but is in serious condition now,” said another.

Third from bottom in the city rankings, Lisbon appears to be on the periphery of southern European markets for international investors because of its economic outlook. For this reason, very few comments were made regarding Lisbon or Portugal, but the latest data show property market fundamentals are weak: just €75 million of sales were transacted in 2011, and slack occupier demand is leading to increasing incentives. Prime office yields have moved to 7 percent. Retail landlords are reporting a decline in sales, and available supply on the high street—where demand is focused—is limited for new investment.

Lisbon-based respondents were highly negative about the coming year for reasons explained more fully earlier in this chapter. And with Prime Minister Pedro Passos Coelho’s feisty budget and austerity measures on the way, the city is unlikely to sense a change in sentiment anytime soon.

**Athens (27).** “Athens is probably best avoided,” said one interviewee based in the city. The state of the Greek economy is bleak, and this is weighing on prospects for the whole business environment in the country. “Commerce in the country has virtually come to a halt, and this affects all business sectors.” “As the Greek banking sector sits today, the debt market is not expected to be accessible in 2012.” Athens ranked last in the survey for existing investments, new investments, and development.

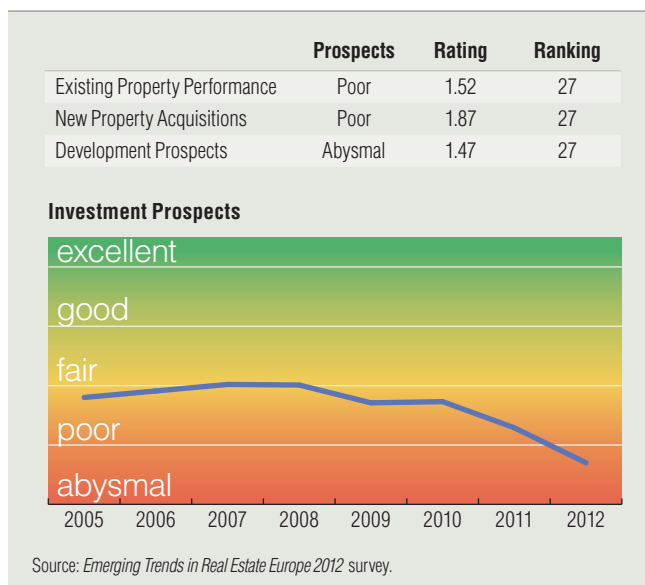
Interviewees report that, long term, the most attractive investments are likely to be situated in tourist areas rather than the city and that this is the future of Greece’s property market. (Hotels were the most favoured sector in Athens.) “This should be viewed in the broadest sense; not just hotels but second homes, health care–related activities, and infrastructure.”

“Assuming that lessons are learned from the mistakes of others, and the product is modern, environmentally friendly, and well planned, then this sector will be successful.”

This view is very much long term, however, and comments were predominantly centred on fears that the economic climate is unlikely to attract new international investors or business occupiers anytime soon. “Buyer interest is coming primarily from private local investors looking for bargains and distressed properties, and we have seen some deals by shipping owners.”

In December 2011, the government began a major asset sales programme in the hope of recouping €25 billion to go towards healing its sovereign debt woes; it is currently seeking developers to take on the redevelopment of the former international airport, Hellinikon. Whether this initiative excites much interest from investors in 2012 will be interesting to see.

EXHIBIT 3-32  
**Athens**



# Interviewees

## **Aberdeen Asset Management**

Magnus Kenning

## **ABN AMRO**

Robert van Deelen

## **Accura**

Henrik Groos

## **AFIAA Investment AG**

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## **Akelius Fastigheter**

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## **ANJOCA, S.L.**

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## **APG Asset Management**

Patrick Kanter

## **Apollo Global Management**

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## **AREA Property Partners**

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## **Areal Bank–Copenhagen**

Per Andersen

## **AREIM**

Nils Styf

## **Art-Invest Real Estate Management GmbH & Co KG**

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## **ASR Real Estate Investment Management**

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## **Avestus Real Estate**

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## **Aviva Investors**

David Skinner  
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## **AXA**

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## **Bank of America Merrill Lynch**

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## **Barclays Corporate**

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## **Bayerische Landesbank**

Ingo Glaeser

## **Beni Stabili**

Alexandre Astier

## **Beni Stabili Gestioni SGR**

Anna Pasquali

## **Benson Elliot Capital Management**

Marc Mogull

## **BerlinHyp**

Roman Berninger

## **Bluehouse Capital**

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## **BNP Paribas**

Peter Denton

## **BNP Paribas Real Estate Investment Management**

Moyse Daarga

## **BNP Paribas Real Estate Italy**

Cesare Ferrero

## **Bouwinvest**

Dick van Hal

## **BRE Bank Hipoteczny S.A.**

Jan Robert Nowak

## **British Land European Fund Management LLP**

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## **Brookfield Asset Management**

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## **Budimex Nieruchomości Sp. z o.o.**

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## **BZ WBK AIB TFI**

Agnieszka Jachowicz

## **CA IMMO Real Estate**

Marian Roman

## **Cadena Group**

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## **Çalık Gayrimenkul**

Dr. Feyzullah Yetgin

## **Canada Life**

John Garlick

## **Canada Pension Plan Investment Board**

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## **Capital & Marketing Group**

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## **Castellum AB**

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Peter Kasch

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Marco Hekman

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Ivo de Wit

## **CBRE Global Investors Central Europe s.r.o.**

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## **CNP-Marfin Insurance Holdings**

Takis Phidia

## **Cofinimmo**

Serge Fautré

## **Colony Capital**

Serge Platonow

## **Commercial Estates Group**

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## **Conygar Investment Company Plc**

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## **Cordea Savills**

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Justin O'Connor

## **Corio France**

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## **Corio Italia**

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**GIC Real Estate International**

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**GMP**

Francisco Montoro

**Goodman**

Danny Peeters

**Great Portland Estates**

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**KF Fastigheter AB**

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Frédéric de Klopstein

**KLP Eiendom AS**

Gorm Gudim

**Knight Frank**

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Nick Thomlinson  
Andrew Watt

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**Land Securities Group PLC**

Martin Greenslade

**LaSalle Investment Management**

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**Macquarie Bank**

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**Mattssons Fastighetsutveckling**

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**SDA Bocconi**

Armando Borghi

**SEGRO PLC**

David Sleath

**Selvaag Eiendom AS**

Per Bomann-Larsen

**SILIC**

Bruno Meyer

**Société de la tour Eiffel**

Robert Waterland

**Société Foncière Lyonnaise**Bertrand Julien-Laferrière  
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Jerry Boschi

**Spiegelfeld Immobilien GmbH**

Georg Spiegelfeld

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Jeffrey G. Dishner

**Starwood Hotels and Resorts**

Core Martin

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**Syntrus Achmea Vastgoed**Geert de Nekker  
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Daniel Loureda

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**Tishman Speyer**

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**TLG Immobilien GmbH**

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**Tofarco**

Nicholas K. Tofarides

**Towers Watson**

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**Trastor REIT**

Sotiris Theodoridis

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Dominic von Felten**UBS Global Real Estate**Jesús Silva Gallardo  
Peter Röhrenbach**Unibail Rodamco**

Peter van Rossum

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**UniCredit Bank Austria AG**Karla Schestauber  
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The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI is committed to

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- Fostering collaboration within and beyond ULI's membership through mentoring, dialogue, and problem solving;
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- Sharing knowledge through education, applied research, publishing, and electronic media; and
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## Emerging Trends in Real Estate® Europe 2012

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